2

No. 2593.

In the

United States Circuit Court of Appeals

For the Ninth Circuit.

F. G. NOYES, as Receiver of WASHINGTON-ALASKA BANK, a Corporation, - - - - - - - - *Appellant,*

VERSUS

R. C. WOOD, JOHN L. McGINN, RAY BRUMBAUGH, J. A. JESSON, JAMES W. HILL, E. R. PEOPLES, J. A. HEALEY, JOHN A. CLARK and GEORGE PRESTON, - - - - - - - - - - - - - - *Appellees.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF ALASKA, FOURTH DIVISION.

BRIEF *of* APPELLANT.

O. L. RIDER,
St. Louis, Mo.,
Attorney for Appellant.

In the

UNITED STATES CIRCUIT COURT OF APPEALS

For the Ninth Circuit.

No. 2593

F. G. NOYES, as Receiver of WASHINGTON-ALASKA BANK, a Corporation, - - - - - - - *Appellant,*

VERSUS

R. C. WOOD, JOHN L. McGINN, RAY BRUMBAUGH, J. A. JESSON, JAMES W. HILL, E. R. PEOPLES, J. A. HEALEY, JOHN A. CLARK and GEORGE PRESTON, - - - - - - - - - - - - - *Appellees.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF ALASKA, FOURTH DIVISION.

INDEX.

In the

UNITED STATES CIRCUIT COURT OF APPEALS

For the Ninth Circuit.

No. 2593

F. G. NOYES, as Receiver of WASHINGTON-ALASKA BANK, a Corporation, - - - - - - - *Appellant,*

vs.

R. C. WOOD, JOHN L. McGINN, RAY BRUMBAUGH, J. A. JESSON, JAMES W. HILL, E. R. PEOPLES, J. A. HEALEY, JOHN A. CLARK and GEORGE PRESTON, - - - - - - - - - - - - *Appellees.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF ALASKA, FOURTH DIVISION.

BRIEF *of* APPELLANT.

Statement.

This is a suit brought by the Receiver of the Washington-Alaska Bank of Nevada, a corporation formerly doing business at Fairbanks, Alaska, against the officers and directors thereof to recover

for certain wrongful, fraudulent or illegal acts on their part by which the funds of said bank were wasted, dissipated or diverted.

The Washington-Alaska Bank of Nevada was originally incorporated under the name of Fairbanks Banking Company, a corporation organized in March, 1908, to succeed and take over the business of a partnership theretofore doing a banking business under the like name of Fairbanks Banking Company. This partnership was composed of E. T. Barnette, James W. Hill and R. C. Wood who, upon the organization of the corporation, transferred to it the assets of said partnership in exchange for capital stock and remained with it as officers thereof. At the time of the organization of the corporation above referred to, there were two other banks doing business in Fairbanks, namely: The First National Bank, and Washington-Alaska Bank of *Washington*. At one time during the period covered by this litigation, the corporation known as Fairbanks Banking Company owned the entire capital stock of the other two banks. About May 4, 1910, it sold the entire capital stock of said First National Bank to two of the defendants herein, John L. McGinn and R. C. Wood. Afterwards, on October 1, 1910, said Fairbanks Banking Company and said Washington-Alaska Bank of Washington combined, and thereafter said Washington-Alaska Bank of Washington ceased to exist or do business as a bank, and said Fairbanks Banking Company, by amendment to its articles of

incorporation, changed its name to Washington-Alaska Bank of *Nevada*, and continued to do business as a bank under that name until the appointment of the Receivers on January 6, 1911. Endeavor will be made to avoid as much as possible the confusion attendent upon this shifting of names.

The Board of Directors of the plaintiff bank did not consist of the same persons during the entire period of its existence, and only one of the defendants named in the petition upon whom service was had, namely, John A. Jesson, was such director during said entire period, and therefore charged with liability for each and all of the transactions complained of. The other officers and directors before the court are charged with liability for only those transactions alleged to have occurred during the terms of their respective office, and such officers are pointed out as each transaction complained of is hereinafter discussed. Generally speaking, it was sought to charge the respective officers and directors with liability for loss of the bank's funds *(1)* arising out of the taking over of the affairs of said partnership; *(2)* in purchasing shares of its own stock from certain of its stockholders; *(3)* for wrongfully declaring and paying a dividend; *(4)* for interest upon the amount of its funds invested in said capital stock of said First National Bank; *(5)* for purchasing the stock of the Washington-Alaska Bank of Washington at a gross overvaluation.

Trial was had to the court and Findings of Fact and Conclusions of Law were made and entered (Rec., pp. 171-199). Upon its Findings of Fact, and in accordance with said Conclusions of Law, the court entered a decree against the proper defendants for certain of said stock purchases and also on account of the declaring and paying of said dividend, and dismissed the action as to all other matters and things set up in the complaint (Rec., pp. 200-203). Appellant, plaintiff below, asked for certain Conclusions of Law granting him recovery upon the matters included in said dismissal (Rec., pp. 204-206), which were denied by the court (Rec., pp. 217) and such denial in each instance was excepted to on the ground that the same is "contrary to the facts found by the court and contrary to law." (Rec., pp. 218-220; Exs. 3-11.)

Appellant herein also saved exceptions to said Conclusions of Law and Decree based thereon in so far as they dismissed his cause of action on the ground that the same in each instance was "contrary to the facts found by the court and contrary to law." (Rec., pp. 220-221; Exs. 12, 13, 14.)

The appellees proposed to the court certain Findings of Fact, among which were those numbered 36 and 51 (Rec., pp. 206-209), which were adopted by the court as its Findings Nos. 45 and 49 (Rec., pp. 189-190-1.)

Appellant objected to each of said proposed Findings (Rec., p. 209) and also duly excepted to the granting of each and to the making of each a Finding by the court (Rec., pp. 217, 218; Exs. 1 and 2), said objection and exception as to each of said Findings as proposed and made being upon the ground that it is not supported by the evidence, is contrary to the evidence and is an incomplete statement or finding as to the matters therein involved as shown by the evidence. The substance of the whole of the testimony introduced and received on the trial respecting the matter covered by each of said Findings as proposed and made is preserved and incorporated in the Bill of Exceptions (Rec., pp. 209-217), and is hereinafter quoted in full at the place where said objections and exceptions are considered in this brief.

All of the foregoing objections and exceptions are presented in Assignments of Error Nos. 1 to 21 (Rec., pp. 227-234). The case is here to test the correctness of said Findings of Fact Nos. 45 and 49 and also to test the accuracy of the court's Conclusions of Law and the Decree upon the facts as found and proven, with the prayer that said Decree be corrected so as to grant appellant the relief prayed for in his petition and that this court shall render a proper decree on the record. Said Findings of Fact and Conclusions of Law are as follows (Rec., pp. 172-199):

"FINDINGS OF FACT AND CONCLUSIONS OF LAW.

I.

" That the Washington-Alaska Bank, of which the plaintiff is receiver, was incorporated under the laws of the State of Nevada on the 21st day of January, 1908, with an authorized capital stock of $300,000.00 divided into 3,000 shares of the par value of $100.00 each; that said bank was incorporated under the name of the Fairbanks Banking Company; and that subsequently, by amendment to its Articles of Incorporation, said name was changed to Washington-Alaska Bank.

II.

" That said bank commenced business in the town of Fairbanks, Alaska, on the 16th day of March, 1908, with a subscribed capital of $206,000.00, part of which was paid for in cash, part in property, and the balance by the promissory notes of the subscribers.

III.

" That prior to the 21st day of January, 1908, subscriptions for said capital stock were circulated, and the following persons among others, subscribed for shares thereof, to-wit. E. T. Barnette, 440 shares; R. C. Wood, 220 shares; James W. Hill, 220 shares; the name of R. C. Wood being subscribed thereto by said E. T. Barnette.

IV.

" That prior to the incorporation of said bank, the said Barnette, Hill and Wood, as copartners, were conducting a banking business in said town of Fairbanks under the firm name

and style of Fairbanks Banking Company, which said company in December. 1907, owing to financial difficulties, was unable to meet its obligations and was compelled to suspend business and close its doors, and was at the time of the organization of said corporation, in the hands of trustees.

V.

" That said corporation was organized, among other things, for the purpose of taking over the business and affairs of said partnership and assuming its outstanding obligations.

VI.

" That the capital of said partnership was $200,000.00, which belonged to said Barnette, and the agreement existing between said partners was that the profits of said partnership were to be divided, one-half to said Barnette, and one-fourth each to said Hill and Wood.

VII.

" That thereafter, and in the fore part of January, 1908, a large number of business, professional and mining men of the Fairbanks Recording District, Alaska, met in the town of Fairbanks, Alaska, for the purpose of organizing a corporation to purchase and take over and absorb the business of the Fairbanks Banking Company, a partnership, and at said meeting negotiations were begun by said proposed incorporators with said copartnership for the purchase of the same. That at said meeting a committee was appointed to go into the details of the reorganization of the Fairbanks Banking Company, and to report a basis upon which the business should be taken over, two of the mem-

bers of this committee having been members of the committee of depositors which had in December examined the assets.

VIII.

" That said committee met on the 5th day of January, 1908, and, after investigating the affairs of the bank, made the following report to be presented for the consideration of the proposed new corporation:

" *(a)* That the issued stock for the proposed new corporation be as of date February 15, 1908; that notes be taken for all deferred payments; that the same bear interest at the rate of one per cent per month from February 15, 1908, until paid; that twenty-five per centum of the unpaid for stock be due and payable on or before June 1st, 1908, and that the balance be due and payable on or before July 1st, 1908.

" *(b)* That Captain E. T. Barnette and James W. Hill, with such associates as they may require, prepare a subscription list.

" *(c)* That the amounts subscribed by any person be left to that person, and in case of over-subscription should be reduced proportionately.

" *(d)* That the notes, properties and securities of the Fairbanks Banking Company, the old institution, examined by its present acting board of trustees and on which a valuation of $288,000.00 in excess of its liabilities was placed, be accepted.

" *(e)* That all notes, properties and securities which said board of trustees placed in the No. 3, or doubtful class remain the property of the old institution.

" *(f)* That all interest on existing loans as of December 19, 1907, be computed to February 15, 1908, and that the amount of such accrued interest be placed to the credit of the old institution on the books of the new corporation, and that the same be payable on or before December 31, 1908.

" *(g)* That should James W. Hill and R. C. Wood not take the full forty-four thousand dollars in stock in the new corporation, the balance of the amount not so taken to be paid to them not later than July 1st, 1908.

" *(h)* That the proposition of Captain E. T. Barnette to leave on deposit with the new corporation the sum of two hundred thousand dollars, without interest for one year, be accepted, and that it be the understanding that such deposit will secure said new corporation against any adverse decision of the Court in the *Caustens* v. *Barnette* suit in so far as such decision may decrease the value of the Gold Bar Lumber Company property as accepted by the present board of trustees.

" *(i)* That the officers of the new corporation be a president, vice-president, second vice-president, cashier, assistant cashier, treasurer, and secretary.

" *(j)* That the number of the Board of Directors be twelve, f o u r to be elected for six months, four for twelve months, and four for eighteen months or until their respective successors are duly elected and qualified.

" *(k)* That dividends be declared semi-annually on June 30, and December 31.

IX.

" That said report was, on January 6th, 1908, submitted to said proposed incorporators, and at said meeting the said report was read, and passed on section by section as read, and on motion duly made and carried was adopted and ordered kept as a part of the records of said meeting.

X.

" That at said meeting a subscription list, a copy of which is set forth in paragraph 3 of the amended complaint in this cause, was presented and signed by said proposed incorporators, setting forth the amount for which each respectively subscribed.

XI.

" That at said meeting it was also agreed on behalf of the Fairbanks Banking Company, a copartnership, that said partnership would turn over to said corporation the property of said Fairbanks Banking Company, a partnership, on the terms specified in said report, and said proposed incorporators in behalf of said proposed corporation, in consideration thereof, agreed to assume the liabilities of said partnership.

XII.

" That said Fairbanks Banking Company, a corporation, became such on the 21st day of January, 1908. That on the 8th day of February, 1908, a meeting of the subscribers of the capital stock of the Fairbanks Banking Company was held for the purpose, among others, of obtaining notes of the subscribers for the stock subscribed by them, and, at said meeting, said stock notes were subscribed by said subscribers of stock and delivered to said corporation.

" That at the time of said meeting the Articles of Incorporation of said Fairbanks Banking Company had not been received from the State of Nevada, and for the purpose of expediency it was deemed advisable to elect a Board of Directors, and twelve directors were elected at said meeting, and it was agreed that said Board of Directors should act as such until the arrival of the Articles of Incorporation, when a formal meeting would be held and proper by-laws be adopted.

XIII.

" That said Articles of Incorporation did not arrive in Fairbanks until some time in the month of March, 1908, and immediately thereafter a meeting of the stockholders of the Fairbanks Banking Company, a corporation, was called, and at said meeting said stockholders, among other things, adopted by-laws and elected a Board of Directors; and also passed a resolution to the effect that the matter of taking over the property of the Fairbanks Banking Company, a partnership, be left to the Board of Directors.

" That on the 12th day of March, 1908, at said meeting of the subscribers to said capital stock, said subscriptions were accepted by them and the above-named Barnette, Hill and Wood, together with the other subscribers, were declared to be stockholders of the said corporation. The defendant Wood was not present at said meeting, but he was notified of the result of the same by the defendant Hill.

XIV.

" Subsequently, at a meeting of the stockholders of said corporation, it was resolved that

the matter of taking over the business and affairs of said partnership be left to the Board of Directors. Thereafter, on March 12, 1908, at a meeting of the Board of Directors, said matter was considered by them and the resolutions of the proposed stockholders, set out in Finding VIII hereof, were by said directors adopted and approved, except that the resolution providing for the payment of accrued interest up to February 15, 1908, was by them amended so as to read 'March 15, 1908.' At the same meeting it was ordered by said Board of Directors that stock issue to said Barnette, Hill and Wood in exchange for the property received from them by said corporation, as follows: Barnette, 440 shares; Hill, 220 shares; Wood, 220 shares.

XV.

" That on the 16th day of March, 1908, a written agreement was entered into between said corporation and said partners, and on the same day the same was signed by the said Barnette and Hill, and also on behalf of said bank by its president and secretary, wherein the valuation of the resources of said partnership was fixed at $790,940.31 and its liabilities at $538,940.31, leaving an excess of $252,000.00 belonging to the said Barnette, Hill and Wood, in which said agreement the said Barnette, Hill and Wood agreed to accept stock of the corporation at its par value for the amount of assets in excess of said liabilities, except that $200,000.00 thereof should be placed to the credit of the said Barnette as a special deposit with said corporation upon the terms therein stated. By the terms of said agreement the amount of stock to be issued to Barnette, Hill and Wood was fixed at $52,000.00 instead of $88,000.00 as contemplated by

said resolution and subscription, thus entitling Barnette to 260 shares and Wood and Hill each to 130 shares. A copy of said agreement is annexed to plaintiff's complaint and marked 'Exhibit One.'

XVI.

" That at the time said agreement was entered into, the said Barnette was president of the said corporation and also a member of the Board of Directors; the said Hill was a member of its executive committee and also its vice-president, and the said Wood was its cashier, and the said defendant John A. Jesson was a member of its Board of Directors. That the above-named Wood, Hill and Jesson are all of the officers of the said bank at the time said agreement was entered into upon whom service has been made in this case, and who are now before the court as defendants.

XVII.

" That the matter of preparing the papers for the transfer of said property belonging to said partnership to said corporation was, by the Board of Directors, left to the executive committee, and the said executive committee examined the affairs of said partnership, and, under their direction, said written agreement was prepared and afterward submitted to the Board of Directors for approval, and by them approved.

XVIII.

" That according to the by-laws of said corporation, the said executive committee had the same powers as the Board of Directors, subject to the approval of their acts by said Board of Directors.

XIX.

" That at the time said written agreement was signed and executed, and during all of the negotiations leading up to the making of the same, the defendant Wood was in Seattle, Washington, but he was advised fully concerning the same by the defendant Hill by letter and by telegram.

XX.

" That prior to the return of said Wood to Fairbanks, to-wit, on the 29th day of February, 1908, he offered to sell his stock in said corporation and to take in payment therefor part cash and a note for the balance, to be secured by said stock as collateral security.

XXI.

" That the defendant Wood returned to Fairbanks, some time in the month of April, 1908, and, upon his return, he signed said written agreement so entered into as aforesaid, knowing that the same contained said clause requiring him to take stock for his share of the assets of said partnership so transferred to said corporation in excess of the liabilities thereof as aforesaid, and also knowing that the same did not provide for the payment of said accrued interest.

XXII.

" That of the loans and discounts transferred by said partnership to said corporation, a large amount were then past due, of which then past due paper the sum of $69,908.94 now remains in the hands of the receiver unpaid and uncollectible, which said loans and discounts were accepted by the directors of said corporation at

their face value, and the same were included in those on which the accrued interest referred to in said resolution, was afterward computed.

XXIII.

" That of said notes so past due as aforesaid, there were two executed by the Tanana Electric Company in the sum of $27,997.38, which depended for their value upon the existence of an alleged guaranty of the Scandinavian-American Bank to make advancements sufficient to cover the same; that said alleged guaranty never had any existence in fact, and the claim therefor had been repudiated by said Scandinavian-American Bank prior to the time said note was accepted by said Board of Directors, and said repudiation was known to the members of said board. That said notes are still unpaid, and the same were at all times carried on the books of the said Washington - Alaska Bank, formerly Fairbanks Banking Company, as an asset in the sum of $27,997.38.

XXIV.

" That said Board of Directors and the officers of said bank accepted said notes of the Tanana Electric Company and paid therefor the sum of $27,997.38, with knowledge on the part of each of them that the same depended for their value upon said alleged guaranty alone.

XXV.

" That among the other assets of said partnership so accepted by said officers and directors was four-fifths of the capital stock of the Gold Bar Lumber Company, a corporation existing in the State of Washington, which said stock was accepted and paid for at the valuation of

$341,949.00, and said stock was at all times during the existence of said corporation carried as an asset in said sum.

XXVI.

" That at the first meeting of the Board of Directors, held on the 12th day of March, 1908, the defendant Wood was elected cashier of said bank, at which time he was then in the City of Seattle, Washington, as aforesaid. Immediate notice was given to him of said election.

XXVII.

" That the said Wood accepted said office of cashier while in the said City of Seattle, and, on the 16th day of March, 1908, entered upon the discharge of his duties as such cashier, and, upon his return to said Fairbanks in April, 1908, as aforesaid, entered actively upon such duties and continued to so act until June 29, 1908, when he tendered his resignation as such cashier, and the same was accepted by the Board of Directors to be effective at the close of business on June 30, 1908, and one B. R. Dusenbury, who was then assistant cashier, was elected to succeed Wood as cashier.

XXVIII.

" That at the time said Wood tendered his resignation as cashier as aforesaid, he demanded that there be paid to him the amount of his interest in said partnership assets, to-wit, $13,000.00.

XXIX.

" That a certificate for 130 shares of the capital stock of said corporation had been written up in the name of the defendant Wood, of the

par value of $13,000.00, but the same was never detached from the stock book. That said 130 shares were carried on the books of said bank as outstanding stock from March 16, 1908, to June 30, 1908.

XXX.

" That on the 30th day of June, 1908, with the knowledge, consent and approval of the officers and directors of said bank, a certificate of deposit was issued to and accepted by the said Wood in the sum of $13,000.00, in lieu of said stock, which said certificate was signed by the said B. R. Dusenbury as assistant cashier prior to the time when the said resignation of the said Wood as cashier became effective, and said shares of capital stock were on the same day charged to treasury stock on the books of said bank.

XXXI.

" That subsequently the said Wood drew out in cash from the funds of said bank the amount of the said certificate of deposit, to-wit, $13.-000.00.

XXXII.

" That at the time the said certificate of deposit was issued to said Wood there was in effect a resolution of the said board of directors requiring monthly statements, showing the condition of said bank, to be presented to said Board of Directors and that in accordance with said resolution, there was, during the existence of said bank, presented to said Board of Directors at each monthly meeting thereafter a statement showing the condition of said bank, and said statements were examined in detail by said board and by them ordered filed.

XXXIII.

" That there was submitted to said Board of Directors at its meeting on July 13, 1908, a written report in detail showing the condition of the affairs of said bank, which said report was examined in detail and was ordered filed, and, under the question of this report, the question of refunding to those desirous of giving up their stock in the Fairbanks Banking Company was discussed, and it was the sense of the meeting that any stockholder desirous of giving up the stock, be paid for the same, and the stock returned to the treasury of said bank.

XXXIV.

" That at the time the said certificate of deposit was issued to said Wood, and his shares of stock so charged to treasury stock as aforesaid, the following of the defendants now before the court in this action were among its officers, to-wit, James W. Hill, a member of the executive committee and its vice-president, John A. Jesson, a member of the Board of Directors, R. C. Wood, cashier and a member of its executive committee; and, at said meeting of July 13, 1908, at the time said report was submitted and the sense of said meeting was expressed as aforesaid, the said John A. Jesson was present and participated therein as a member of the Board of Directors, and the said James W. Hill was also present as its vice-president and a member of the executive committee.

XXXV.

" That of the notes accepted from said partnership, as aforesaid, and paid for by said corporation, there were charged on December 31,

1907, by said partnership on the books of said partnership to an account known as 'doubtful account' the sum of $22,979.99, and said doubtful account, so including said notes in said amount, was then depreciated on the said books to the amount of thirty-three and one-third per cent thereof, which said notes were accepted by said corporation and paid for by them in the amount aforesaid, to-wit, $22,979.99, all of which said notes were then past due, and of which there still remains unpaid and uncollectible the sum of $12,860.61. That of said notes so charged to said doubtful account as aforesaid, there was on December 31, 1909, charged by said corporation to the account of profit and loss on the books of said corporation the sum of $12,192.80.

XXXVI.

" That on March 23, 1908, pursuant to said resolution of the said Board of Directors adopted on March 12, 1908, the accrued interest on said loans so transferred to said corporation was computed to March 15, 1908, in the sum of $39,642.81, and one-half thereof was placed to the credit of said Barnette, and one-fourth thereof each to the credit of said Hill and Wood on the books of said corporation, and subsequently the same was paid to said Barnette, Hill and Wood in cash.

XXXVII.

" That of said interest so paid to said Barnette, Hill and Wood as aforesaid, approximately $7,500.00 thereof was never collected by said bank.

XXXVIII.

" That at the time said resolution allowing said interest was adopted, and at the time the amount thereof as aforesaid was placed to the credit of said Barnette, Hill and Wood as aforesaid, on the books of the said bank, the following defendants now before the court in this action were officers of said bank, to-wit, John A. Jesson, member of the board of directors, James W. Hill, member of the executive committee and vice-president, and R. C. Wood, cashier.

XXXIX.

" That at the time said corporation commenced business on March 16, 1908, it had a total subscribed and outstanding capital stock in the sum of $206,000.00, only a small portion of which was paid for in cash, and at no time did the same exceed said amount; and that of its funds $341,949.00 was at all times invested in stock of the Gold Bar Lumber Company, being $135,949, in excess of its subscribed and outstanding stock.

XL.

" That at the time said investment was so made as aforesaid, said Lumber Company was closed down, and immediately prior to closing down, it has been operated at a loss, that in so far as said Lumber Company was able to operate since the purchase of said stock by said corporation, all of its earnings and a part of its surplus have been expended in the purchase and repair of equipment for said mill, and in the operation of said mill its standing timber was being consumed and its best asset exhausted. That no dividends have ever been paid on the capital

stock of said lumber company during the time the same was owned by said bank.

XLI.

" That the Articles of Incorporation of said corporation authorized and empowered said corporation among other things,

> 'To buy and sell gold and silver bullion, foreign coin, stocks, bonds, and all other property, real and personal, and to do any business and exercise any powers incident to the banking business, or necessary or proper to the furtherance and attainment of the purposes of said bank.'

XLII.

" That subdivisions 5 and 6 of Articles XII of the by-laws of said corporation, adopted at the stockholders' meeting held March 12, 1908, provided that all issued and outstanding stock of the company that may be donated to, or purchased by the company, or which shall revert by reason of failure to pay for the same, shall be treasury stock, and shall be held subject to the disposal of the action of the Board of Directors. Said stock shall neither vote nor participate in dividends while held by the company. The Board of Directors shall be given the first option to purchase for the corporation the stock of any stockholder, and shall be entitled to purchase the same provided said Board of Directors shall offer to pay to said stockholder the same amount as he might obtain from any other person.

XLIII.

" That on the 14th day of September, 1908, the executive committee of the said Fairbanks

Banking Company, consisting of Barnette, president, Hill, vice-president, Dusenbury, cashier, and directors Jonas, John Jesson and Ryan, passed a resolution to the effect that said corporation would not take over any more stock of the stockholders, which said resolution of the executive committee was approved and ratified by the board of directors on October 14, 1908, the directors present at said meeting being, Hill, Peoples, Yarnell, Robinson, Ryan, Jonas and Jesson, and also the said Dusenbury was present.

XLIV.

" That after said bank took said stock of said Wood into its treasury, frequent and continuous surrenders of its stock were made by its stockholders, amounting in all to thirty-eight different and distinct transactions, aggregating a total of $43,000, exclusive of said Wood's stock. That the stock so taken back by the corporation was charged to the treasury stock account, and of the same only ten shares of the par value of $1000 were ever re-issued. That said stock surrenders continued down to and including October 25, 1910, when the last surrender was made, being the McGinn stock of the par value of $10,000, for which the sum of $6000 in cash was paid by the bank to said McGinn.

XLV.

" That upon the 18th day of November, 1908, Strandberg Brothers were the owners of 100 shares of the outstanding capital stock of said Fairbanks Banking Company, Emma Strandberg was the owner of 10 shares, and B. E. Johnson was the owner of 10 shares.

" That said stock was taken in part payment

of a loan that the bank had theretofore made to said Strandberg Brothers and said Johnson, who were mining copartners, and the bank also received at said time the further sum of $4,000 in cash, which fully paid said loan. That said transaction amounted to the taking of stock for a pre-existing debt, rather than the purchase of stock by the Board of Directors. That said directors believed at said time said loan was precarious, and said directors, in taking said stock in partial satisfaction of said loan, did so in good faith and believing it to be for the best interests of the corporation.

XLVI.

" That on the 3d day of February, 1909, at a meeting of the executive committee of said bank, it was again resolved that the officers of said bank be directed to say that 'the corporation did not desire to buy in its stock at present,' which said resolution of the said executive committee was thereafter and on, to-wit, the 13th day of February, 1909, approved and ratified by the said board of directors.

XLVII.

" That on the 15th day of March, 1909, H. B. Parkin, who was the owner of 10 shares of the outstanding capital stock of said bank, and Oscar Tackstrom, who was the owner of 5 shares of the said outstanding capital stock, requested the executive committee of said bank to buy their stock.

" That said executive committee thereupon again announced its policy, by resolving, 'It was the sense of the meeting that the bank observe the rule established at a previous meeting of the

board wherein it was declared not to buy in any more stock,' which said resolution was approved and ratified by the board of directors at said meeting held April 12, 1909, at which meeting of the directors the following officers and directors were present: Barnette, Claypool, Hill, Jesson, Robinson, Yarnell, Brumbaugh, Peoples and Dusenbury.

XLVIII.

" That John L. McGinn was a stockholder of the Washington-Alaska Bank, formerly the Fairbanks Banking Company, and was the owner of 100 shares of the outstanding capital stock of said Washington-Alaska Bank, of the par value of $10,000.

XLIX.

" That a short time prior to the 13th day of October, 1910, John L. McGinn, as a stockholder of the Washington-Alaska Bank, formerly the Fairbanks Banking Company, demanded the right to inspect its books and papers, and threatened that, unless this right was granted him immediately, to make application for an order permitting him to do so and for the appointment of a receiver of the said Washington-Alaska Bank. That the directors of the Washington - Alaska Bank, fearing that information obtained by such an investigation would be used by said McGinn in promoting the interests of the First National Bank in its business, and that if such information was refused and any litigation was started it would impair public confidence in the Washington-Alaska Bank and perhaps start a run of its customers and depositors on said bank, acting under this belief, authorized the cashier to

loan a purchaser sufficient funds to pay for the stock of said McGinn; one of the directors stating at said time that he had a purchaser who would be willing to purchase said stock for the sum of $6000, but it would be necessary for him to borrow money to complete said purchase; that, as the matter was urgent and the purchaser was not immediately available, the cashier purchased the stock in his own name and gave his note to the bank for the amount thereof and paid to said John L. McGinn the sum of $6,000.00 for his 100 shares of capital stock. That thereafter, and on or about the 25th day of October, 1910, said cashier, without the knowledge of any of the directors, cancelled his note and charged the amount thereof to the bank, and surrendered the stock to the bank, and the stock was thereafter held, with other treasury stock of the company.

L.

" That upon said 13th day of October, 1910, the director George Preston, by reason of sickness of his family, was quarantined and unable to attend the meeting of the Board of Directors held on said day, and was not present thereat, and knew nothing of the action taken at the meeting of said board.

LI.

" That when stock was so taken back by the corporation, the amount paid therefor was either paid in cash, or notes held by the bank were cancelled and surrendered to the stockholders.

" That said bank had no surplus or undivided profits against which the same could be charged.

LII.

" That the taking back of said stock and the payment therefor as aforesaid was illegal, wrongful, and in violation of the laws of the State of Nevada under which said corporation was organized.

LIII.

" That after the surrender of the stock of the said Wood, to-wit, from July 13, 1908, to and including September 12, 1908, stock was so taken up in the sum of $13,400.00, during which time the defendant John A. Jesson was a member of the board of directors, and the defendant James W. Hill, a member of its said executive committee.

" That from September 13, 1908, to and including October 13, 1908, stock was so taken up in the sum of $1500.00 during which time the defendants John A. Jesson and James W. Hill were membebrs of the Board of Directors;

" That from October 14, 1908, to and including March 13, 1909, stock was so taken up in the sum of $13,100.00, during which time the defendants Jesson, Hill and Peoples were members of the Board of Directors;

" That from the 14 of March, 1909, to and including September 12, 1909, stock was so taken up in the sum of $1000.00, during which time the defendants John A. Jesson, Hill and Brumbaugh were members of the Board of Directors;

" That from September 13, 1909, to and including October 12, 1909, stock was so taken up in the sum of $3000.00, during which time the defendants John A. Jesson, Hill and Brumbaugh and McGinn were members of the Board of Directors.

" That from October 13, 1909, to and including January 18, 1910, stock was so taken up in the sum of $1000.00, during which time the defendants John A. Jesson, Hill, McGinn and Brumbaugh and Wood were members of the Board of Directors;

" That from January 19, 1910, to and including October 25, 1910, stock was so taken up in the sum of $10,000, for which the said sum of $6,000.00 was paid in cash, and at the time said stock was so taken up the defendants John A. Jesson, Brumbaugh, Clark, Healey and Preston were members of its Board of Directors.

LIV.

" That said stock surrenders so made as aforesaid were acquiesced in by said directors, and in some instances were made under their directions and with their express approval.

LV.

" That in the month of May, 1909, said Fairbanks Banking Company and the Washington-Alaska Bank of Washington, then doing business at Fairbanks, each purchased one-half of the capital stock of the First National Bank of Fairbanks, Alaska, for which each paid the sum of $62,500.00 and continued to own and hold said stock until the month of May, 1910.

" That on or about the 4th of May, 1910, said Fairbanks Banking Company sold the entire capital stock of the said First National Bank to the defendants Wood and McGinn for the sum of $125,000.00 and received said amount in payment therefor, delivering to them the said capital stock of said First National Bank.

" That at the time said banks purchased said stock of the First National Bank, they gave to said Wood an option to purchase the same on or before June 1, 1910, for the sum of $125,000.00, and said sale to said Wood and McGinn was made in pursuance to said option.

" That neither the said Fairbanks Banking Company, nor the said Washington - Alaska Bank of Washington, received any dividend on said stock of the said First National Bank during the time the same was held and owned by them, nor did they, or either of them, receive any interest from the said Wood and McGinn, or from anyone in their behalf, for the money invested in said stock during the time the same was so invested.

LVI.

" That on September 14, 1909, the said Fairbanks Banking Company purchased the entire capital stock of the said Washington - Alaska Bank of Washington, paying therefor the sum of $250,000.00, which said capital stock at said time was of the par value of $150,000.

LVII.

" That at the time the said capital stock of said Washington-Alaska Bank of Washington was so purchased, the defendants J. A. Jesson, James W. Hill and John L. McGinn were members of the Board of Directors of the Fairbanks Banking Company, and said purchase of said capital stock was ratified and confirmed by them as members of said board on the said 14 day of September, 1909.

" That at the time the aforesaid resolution was adopted by the said board of directors to

take over the business and affairs of said partnership; and at the time said written agreement between said corporation and said partners was entered into and confirmed and approved; and at the time said valuation was placed on said capital stock of the said Gold Bar Lumber Company and said stock accepted at such valuation; and at the time said past due notes held by said partners were accepted and paid for by said corporation, including said notes of the said Tanana Electric Company and said notes which had been charged to the doubtful account of said partnership as aforesaid; and at the time said accrued interest on said notes so purchased of said partnership was computed and allowed to said partners and placed to their credit as aforesaid on the books of said corporation, the following defendants now before the court in this action were officers and directors of said corporation and acquiesced in said transactions and gave their consent thereto with full knowledge on the part of each of them of the existence of the facts heretofore found respecting said transactions, to-wit, James W. Hill, vice-president and member of its executive committee, John A. Jesson, member of its board of directors, R. C. Wood, its cashier. That the said Hill and Wood were also members of the partnership with which said corporation contracted respecting said matters and were each personally interested therein adversely to said corporation.

LIX.

" That at the time of the said sale of the said capital stock of the said First National Bank to the said Wood and McGinn, the following defendants now before this court were officers and directors of the said Fairbanks Banking Com-

pany, and each consented to said sale on the terms thereof heretofore stated, to-wit, J. A. Jesson, R. C. Wood, John L. McGinn and Ray Brumbaugh.

LX.

" That on the 12 day of April, 1910, the said Fairbanks Banking Company, by its Board of Directors, declared a dividend of twenty per cent on its then outstanding capital stock of $168,-600.00, which dividend amounted to $33,720.00, and which said sum was paid to the stockholders of said bank either in cash or by crediting the amount thereof upon notes owing by said stock-holders to said bank.

LXI.

" That at the time said dividend was so de-clared and paid, the said Fairbanks Banking Company did not have any surplus or undivided profits out of which the same could be declared and paid.

LXII.

" That said dividend was declared and paid in violation of the laws of the State of Nevada, and also in violation of the by-laws of the said Fairbanks Banking Company, and was wrong-ful and illegal.

LXIII.

" . That at the time said dividend was de-clared and paid, the defendants Wood, McGinn, Brumbaugh and John A. Jesson were members of the board of directors of the said Fairbanks Banking Company, and gave their consent thereto.

LXIV.

" That on the 1st day of October, 1910, the said Fairbanks Banking Company and the said Washington-Alaska Bank of Washington combined, at which time the said Fairbanks Banking Company took over the assets of the said Washington-Alaska Bank of Washington and assumed and agreed to pay its outstanding liabilities; and thereafter the said Washington-Alaska Bank of Washington ceased to exist or do business as a bank, and the Fairbanks Banking Company, by amendment to its Articles of Incorporation, changed its name to Washington-Alaska Bank of Nevada, and continued thereafter to transact business under said name at said Fairbanks, Alaska, until the appointment of the receiver therefor.

LXV.

" That pursuant to the agreement heretofore referred to between the said Fairbanks Banking Company and the said partnership formerly existing between the said Barnette, Hill and Wood, the said sum of $200,000.00 to be paid to the said Barnette was placed to his credit on the books of said corporation as a special deposit, and subsequently the entire sum thereof was paid to the said Barnette in cash and drawn out by him from the funds of said bank.

LXVI.

" That the assets of the said bank now in the hands of the receiver are insufficient to pay its liabilities, and the amount of such liabilities is more than $470,000.00 in excess of the value of said assets.

" CONCLUSIONS OF LAW.

" Upon the foregoing findings of fact, the court finds as conclusions of law:

" *1.* That the defendants Wood, McGinn, Brumbaugh and Jesson are jointly and severally liable in the sum of $33,720.00, by reason of the declaration and payment of the dividend upon the capital stock of the Fairbanks Banking Company on April 12, 1910;

" *2.* That the defendant Jesson is liable in the sum of $13,400.00 by reason of the surrender of shares of capital stock of said company, made between July 13, 1908, and September 12, 1908;

" *3.* That the defendants Jesson and Hill are jointly and severally liable in the sum of $1,500.00, for surrender of shares of capital stock of said Company, made between September 13, 1908, and October 13, 1908;

" *4.* That the defendants Jesson, Hill and Peoples are jointly and severally liable in the sum of $1100.00, for surrenders of shares of capital stock, made between October 14, 1908, and March 13, 1909;

" *5.* That the defendants Jesson, Hill and Brumbaugh are jointly and severally liable in the sum of $1100.00, for surrenders of shares of capital stock of said Company, made between March 14, 1909, and September 12, 1909;

" *6.* That defendants Jesson, Brumbaugh and McGinn are jointly and severally liable in

the sum of $3000.00, for surrenders of capital stock of said Company, made between September 13, 1909, and October 12, 1909;

" *7.* That defendants Jesson, McGinn and Brumbaugh are jointly and severally liable in the sum of $1000.00, for surrenders of capital stock made between October 13, 1909, and January 18, 1910.

" *8.* That the plaintiff is entitled to a decree and judgment against the above-named defendants for the recovery of the sums above mentioned, and that as to the other defendants in this suit this action should be dismissed.

" Dated June 11, 1914.

F. E. FULLER, *District Judge.*

" . Entered in Court Journal No. 12, page 944."

Upon the foregoing Findings of Fact and in accordance with said Conclusions of Law, the court made and entered Decree herein, which is as follows (Rec., pp. 200-203):

" DECREE.

" *Be It Remembered* that on the 22d day of April, A. D. 1914, the above-entitled cause came on regularly for trial before the court, without a jury, upon the issues as joined between the plaintiff and the defendants J. A. Jesson, R. C. Wood, J. A. Healey, E. R. Peoples, John L. McGinn, Ray Brumbaugh, James W. Hill, John A. Clark and George Preston. The Honorable F. E. Fuller, Judge of said court, presiding. The plaintiff appeared in person and by his attorney

O. L. Rider, and the said defendants R. C. Wood, James W. Hill, E. R. Peoples, and John L. McGinn, appearing by their attorneys A. R. Heilig and John L. McGinn, and the defendants J. A. Jesson, Ray Brumbaugh, J. A. Healey, John A. Clark, George Preston and E. R. Peoples appearing by their attorneys McGowan & Clark, and thereupon the respective parties, plaintiff and defendants, from day to day introduced their testimony in support of said issues until the 6th day of May, 1914, when all of said parties rested and the introduction of said testimony was closed, and thereupon the court, after hearing the arguments of counsel and after considering the pleadings and the testimony, and being fully advised in the premises, did, on the 11th day of June, 1914, make and file its findings of fact and conclusions of law upon said issues; and now, to-wit, on this 15th day of June, 1914, the court being fully advised in the premises, it is ordered, adjudged and decreed as follows, to-wit:

I.

" That the plaintiff have and recover of and from the defendants R. C. Wood, John L. McGinn, Ray Brumbaugh and J. A. Jesson, jointly and severally, the sum of $33,720 by reason of the declaration and payment on April 12th, 1910, of the dividend upon the capital stock of the Fairbanks Banking Company set up in the complaint.

II.

" That the plaintiff have and recover of and from the defendant J. A. Jesson the further sum of $13,400.00 by reason of the surrender of

shares of the capital stock of said company made between July 13, 1908, and September 12, 1908.

III.

" That the plaintiff have and recover of and from the defendants J. A. Jesson and James W. Hill, jointly and severally, the further sum of $1,500.00 by reason of the surrender of shares of the capital stock of said company made between September 13, 1908, and October 13, 1908.

IV.

" That the plaintiff have and recover of and from the defendants J. A. Jesson, James W. Hill and E. R. Peoples, jointly and severally, the further sum of $1,100.00 by reason of the surrender of shares of the capital stock of said company made between October 14, 1908, and March 13, 1909.

V.

" That the plaintiff have and recover of and from the defendants, J. A. Jesson, James W. Hill and Ray Brumbaugh, jointly and severally, the further sum of $1,000.00 by reason of the surrender of shares of the capital stock of said company made between March 14, 1909, and September 12, 1909.

VI.

" That the plaintiff have and recover of and from the defendants J. A. Jesson, Ray Brumbaugh and John L. McGinn, jointly and severally, the further sum of $3,000.00 by reason of the surrender of shares of the capital stock of said

company made between September 13, 1909, and October 12, 1909.

VII.

" That the plaintiff have and recover of and from the defendants J. A. Jesson, John L. McGinn and Ray Brumbaugh, jointly and severally, the further sum of $1,000.00 by reason of the surrender of shares of the capital stock of said company made between October 13, 1909, and January 18, 1910.

VIII.

" That the plaintiff take nothing as against the defendants J. A. Healey, John A. Clark and George Preston by reason of any of the matters and things set forth in the complaint herein and that this action be and the same is hereby dismissed as to said J. A. Healey, John A. Clark and George Preston.

IX.

" That the plaintiff take nothing, further than as above specified, against the defendants, R. C. Wood, E. R. Peoples, John L. McGinn, J. A. Jesson, Ray Brumbaugh and James W. Hill, by reason of any of the matters and things set forth in the complaint herein, and that this action be and the same is hereby dismissed as to them in respect to all matters and things set up in the complaint herein, except as to the declaration and payment of said dividend and the surrenders of the shares of the capital stock of said company as above specified;

"   All of which is now finally *ordered, adjudged and decreed* at the cost of the defendants R. C. Wood, E. R. Peoples, John L. McGinn, J. A. Jesson, Ray Brumbaugh and James W. Hill.

"   Let execution issue for the enforcement of above judgment and decree against the defendants R. C. Wood, E. R. Peoples, John L. McGinn, J. A. Jesson, Ray Brumbaugh and James W. Hill.

"   Dated Fairbanks, Alaska, this 15th day of June, 1914.

F. E. FULLER,

Judge of the District Court, Territory of Alaska, Fourth Division.

"   Entered in Court Journal No. 12, page 958."

SPECIFICATIONS *of* ERROR.

I.

The court erred in granting defendants' proposed Finding of Fact No. XXXVI, and in adopting the same over plaintiff's objection as Finding of Fact XLV by the court.

II.

The court erred in granting defendants' proposed Finding of Fact No. LI and in adopting the same over plaintiff's objection as Finding of Fact No. XLIX by the court.

III.

The court erred in denying plaintiff's proposed Conclusion of Law No. 1, which is as follows:

> "The defendants John A. Jesson, James W. Hill, and R. C. Wood are jointly and severally liable for the following items:

Purchase of Tanana Electric Company notes..................	$27997.38
Purchase of other past due notes from the partnership which are still unpaid..................	41911.56
Accrued interest on partnership notes paid to Barnette, Hill and Wood and which was not collected..................	7500
Balance of accrued interest paid to Barnette, Hill and Wood partnership notes purchased......	32142.81
Surrender of Wood's stock........	13000.00"

IV.

The court erred in denying that portion of plaintiff's proposed Conclusion of Law No. 1, which is as follows:

"Purchase of Tanana Electric Company notes. . . . .$27997.38"

V.

The court erred in denying that portion of plaintiff's proposed Conclusion of Law No. 1, which is as follows:

"Purchase of other notes past due from the partnership. . . . .$41911.56"

VI.

The court erred in denying that portion of plaintiff's proposed Conclusion of Law No. 1, which is as follows:

"Accrued interest on partnership notes paid to Barnette, Hill and Wood and which was not collected. . . . .$ 7500."

VII.

The court erred in denying that portion of plaintiff's proposed Conclusion of Law No. 1, which is as follows:

"Balance of accrued interest paid to Barnette, Hill and Wood on partnership notes purchased. . $32142.81"

VIII.

The court erred in denying that portion of plain-

tiff's proposed Conclusion of Law No. 1, which is as follows:

"Surrender of Wood's stock......$13000."

IX.

The court erred in denying plaintiff's proposed Conclusion of Law No. 6 in so far as the same relates to the surrender of $12,000 worth of stock, being the stock of Strandberg Brothers, $10,000; Emma Strandberg, $1,000; B. E. Johnson, $1,000, which said conclusion of law is as follows:

> " The defendants John A. Jesson, James W. Hill and E. R. Peoples are jointly and severally liable for surrenders of stock made between October 14, 1908, and March 13, 1909, in the sum of $13,100.00."

X.

The court erred in denying plaintiff's proposed Conclusion of Law No. 10, which is as follows:

> " The defendants John A. Jesson, Ray Brumbaugh, John A. Clark, J. A. Healey, and George Preston are jointly and severally liable for surrenders of stock made between January 19, 1910, and October 25, 1910, in the sum of $6,000.00."

XI.

The court erred in denying plaintiff's proposed Conclusion of Law No. 11, which is as follows:

> " The defendants J. A. Jesson, R. C. Wood, John L. McGinn and Ray Brumbaugh are jointly and severally liable for one year's interest

upon the amount invested in the stock of the First National Bank and sold to McGinn and Wood $10,000.00."

XII.

The court erred in making that portion of Conclusion of Law No. 8 by the court, which is as follows:

"and that as to the other defendants in this suit this action should be dismissed."

XIII.

The court erred in making and entering paragraph 8 of the decree herein, which is as follows:

" That the plaintiff take nothing as against the defendants J. A. Healey, John A. Clark and George Preston by reason of any of the matters and things set forth in the complaint herein and that this action be and the same is hereby dismissed as to said J. A. Healey and John A. Clark and George Preston."

XIV.

The court erred in making and entering paragraph 9 of the decree herein, which is as follows:

" That the plaintiff take nothing, further than as above specified, against the defendants R. C. Wood, E. R. Peoples, John L. McGinn, J. A. Jesson, Ray Brumbaugh and James W. Hill, by reason of any of the matters and things set forth in the complaint herein, and that this action be and the same is hereby dismissed as to them in respect to all matters and things set up in the complaint herein, except as to the declaration and payment of said dividend and the surrender of the shares of the capital stock of said company as above specified."

XV.

The court erred in refusing to enter judgment and decree in favor of plaintiff and against the defendants, J. A. Jesson, James W. Hill and E. R. Peoples, on account of the surrender of $12,000.00 worth of stock between October 14, 1908, and March 13, 1909, being the stock of Strandberg Brothers, $10,-000.00, Emma Strandberg, $1,000.00, B. E. Johnson, $1,000.00, and in dismissing plaintiff's action therefor.

XVI.

The court erred in refusing to enter judgment and decree in favor of the plaintiff and against the defendants, J. A. Jesson, Ray Brumbaugh, John A. Clark, J. A. Healey and George Preston in the sum of $6,000.00 for surrenders of stock made between January 19, 1910, and October 25, 1910, and in dismissing plaintiff's action therefor.

XVII.

The court erred in refusing to make and enter decree and judgment against the defendants J. A. Jesson. James W. Hill and R. C. Wood in the sum of $27,997.38, on account of the purchase of the Tanana Electric Company notes.

XVIII.

The court erred in refusing to make and enter judgment and decree in favor of the plaintiff and against the defendants, J. A. Jesson, James W. Hill and R. C. Wood in the sum of $41,911.56 on account of the purchase from the partnership of notes other

than said Tanana Electric Company notes, which were past due at the time of purchase and are still unpaid.

XIX.

The court erred in refusing to make and enter judgment in favor of the plaintiff and against the defendants, J. A. Jesson, James W. Hill and R. C. Wood, in the sum of $7,500.00, on account of accrued interest on notes purchased from the partnership, which was paid to Barnette, Hill and Wood, and which is still uncollected.

XX.

The court erred in refusing to make and enter judgment in favor of the plaintiff and against the defendants J. A. Jesson, James W. Hill and R. C. Wood, in the sum of $32,142.81 on account of the balance of accrued interest paid to Barnette, Hill and Wood on partnership notes purchased.

XXI.

The court erred in refusing to make and enter judgment in favor of the plaintiff and against the defendants J. A. Jesson, James W. Hill and R. C. Wood, in the sum of $13,000.00 on account of the surrender of Wood's stock.

The foregoing assignments will be considered under the headings set out in the Brief of the Argument.

BRIEF *of the* ARGUMENT.

I.

Purchases of Stock of the Strandbergs, Johnson and McGinn.

(*a*) Said purchases were illegal, wrongful and in violation of the laws of the State of Nevada under which said corporation was organized (F. 52, R. 192).

(*b*) At the time said stock was purchased, said corporation had no surplus or undivided profits against which the same could be charged (F. 51, R. 192).

(*c*) Said purchases were acquiesced in by the directors and in some instances were made under their direction and with their express approval (F. 54, R. 193).

(*d*) The Strandberg and Johnson stock was not taken back by the bank in satisfaction of a pre-existing indebtedness (R. 214-217, substance of evidence thereon); but said stock was purchased or taken back pursuant to an established custom of the bank.

(*e*) The taking back of the McGinn stock was a purchase by the bank pursuant to an established custom of the bank. Hawkins, the cashier, was acting as agent of the bank in so doing and not

for himself (F. 33, 44; substance of evidence thereon, R. 209-214).

—*In re S. P. Smith Co.*, 132 Fed. 618;
Shuey v. *Holmes*, (Wash.) 54 Pac. 540.

(f) The directors having authorized the advancement of the funds of the bank for the purpose of taking up the McGinn stock are liable therefor even though the stock was purchased for Hawkins individually.

—*Green* v. *Hedenberg*, (Ill.) 42 N. E. 851.

(g) These stock purchases were made in defiance of the laws of Nevada under which this corporation was organized and amount to a division of the capital among the stockholders.

—*Thompson* v. *Reno Savings Bank*, (Nev.) 7 Pac. 68.

(h) When a person becomes a member of a corporation organized under the laws of another state, he consents to be governed by the corporation laws of that state and his rights and liabilities are determined by the laws of that state.

—*Geissen* v. *London etc. Co.*, 102 Fed. 584, 42 C. C. A. 515;
Silver Mines v. *Brown*, 58 Fed. 644, 7 C. C. A. 412;
Relfe v. *Rundle*, 103 U. S. 222, 26 L. ed. 337;
Railway Co. v. *Gebbard*, 109 U. S. 527.

(i) The decisions of the Supreme Court of Nevada are controlling in the construction of its statutes.

—*Fairfield* v. *County of Gallatin*, 100 U. S. 50.

(j) A corporation may not purchase its own stock when prohibited by statute, or out of its capital, or when to do so is prejudicial to creditors and other stockholders.

—Cook on Corporations (6th ed.), Sec. 311;

Thompson on Corporations, Secs. 1548, 2054;

Morawetz on Private Corporations, Sec. 112;

In re Smith Lumber Co., 132 Fed. 618;

Lowe v. *Pioneer Threshing Co.*, 70 Fed. 646;

Tolman v. *N. M. & D. Mica Co.*, (Dak.) 22 N. W. 505;

Vercoutre v. *Golden State Land Co.*, (Cal.) 48 Pac. 375;

Kassler v. *Kyle*, (Col.) 65 Pac. 34;

Martin v. *Zellerback*, 38 Cal. 307;

F. N. B. v. *Salem etc. Co.*, 39 Fed. 89, 95-97;

Commissioner v. *Thayer*, 94 U. S. 631, 643, 24 L. ed. 133;

Bank v. *Lanier*, 11 Wall. 369, 20 L. ed. 172;

Hall v. *Alabama, etc. Co.*, 143 Ala. 468, 39 So. 285;

Currier v. *Slate Co.*, 56 N. H. 262;

Hamor v. *Taylor Rice Eng. Co.*, 84 Fed. 187;

Farrington v. *Tennessee*, 95 U. S. 679, 686;

In re Brocking Mfg. Co., (Me.) 35 Atl. 1012;

Tait v. *Pigott*, (Wash.) 80 Pac. 172;

Adams & Westlake Co. v. *Deyette*, 5 S. D. 418, 425, 8 S. D. 127;

German Sav. Bk. v. *Wulfekuhler*, 19 Kan. 60;

Hall v. *Henderson*, 126 Ala. 449, 28 So. 531;

Crandell v. *Lincoln*, 52 Conn. 73;

Com. Nat. Bk. v. *Burch*, 141 Ill. 519, 32 N. E. 420;

Clapp v. *Peterson*, 104 Ill. 26;

Bank v. *Ross*, 68 Conn. 29;

Rogers v. *Ogden etc.*, 30 Utah 188;

New Eng. Trust Co. v. *Abbott*, 162 Mass. 148;

Blalock v. *Kernerville Mfg. Co.*, 110 N. C. 99;

Van Brocklin v. *Queen etc. Co.*, 19 Wash. 552.

(k) The cases of *In re Castle Braid Co.*, 145 Fed. 224; *Copper Bell Mining Co.* v. *Costello*, 95 Pac. 94, and *Barto* v. *Nix*, 46 Pac. 1033, are not opposed to the principle of the foregoing cases.

(l) The bank had a right of action against these faithless officers. The Receiver can enforce as an asset of the bank any remedy which the bank had.

—Zane on Banking, Sec. 86;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567.

(*m*) Directors are liable for investment of the bank's funds *in ultra vires* or unauthorized or forbidden enterprises.

—1 Michie on Banks & Banking, pages 341, 342;

Cooper v. *Hill*, 36 C. C. A. 402;

Briggs v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;

Trustees v. *Bossieux*, 3 Fed. 817;

Thompson v. *Greeley*, 107 Mo. 577, 591-2;

Marshall v. *Bank*, (Va.) 8 S. E. 586, 2 L. R. A. 534;

Oakland Bank v. *Wilcox*, 60 Cal. 126;

Stone v. *Rottman*, 183 Mo. 552, 82 S. W. 76, 83-84;

In re Brocking Mfg. Co., (Me.) 35 Atl. 1012;

Green v. *Hedenberg*, (Ill.) 42 N. E. 851;

Boswell v. *Allen*, 168 N. Y. 157, 55 L. R. A. 751;

U. S. v. *Britton*, 108 U. S. 199, 27 L. ed. 698;

Evans v. *U. S.*, 153 U. S. 584, 38 L. ed. 830;

German Sav. Bk. v. *Wulfekuhler*, 19 Kan. 60;

Boyd v. *Schneider*, 65 C. C. A. 209, 131 Fed. 223;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567.

(*n*) Any by-law of this corporation which may have authorized it to make said stock purchases is void because in violation of the laws of Nevada.

—*State ex rel Corey* v. *Curtis*, 9 Nev. 325;
Herring v. *Ruskin Co-op. Ass'n*, (Tenn.) 52 S. W. 327;
Vercoutre v. *Golden State Land Co.*, (Cal.) 48 Pac. 375;
Cooper v. *Hill*, 36 C. C. A. 402, 407.

II.

Purchase of Stock From Wood.

(*a*) Wood was a stockholder of the corporation (F. 13, 14, 15, 20, 27, 29).

(*b*) He afterwards, on June 30, 1908, sold his stock to the corporation and received therefor $13,000 of its funds. This transaction was with the knowledge, consent and approval of the officers and directors of the corporation (F. 30, 31, 32, 33, 54).

(*c*) The purchase of said stock by the bank amounted to division of the capital, or a payment out of the money of the depositors, and was illegal, wrongful and in violation of the laws of Nevada (F. 51, 52).

(*d*) This is not an action between the parties to a contract for rescission of a completed contract; but is an action against faithless officers and agents for diverting and dissipating the funds of the bank.

(e) None of the exceptions sometimes recognized to the rule forbidding a corporation to purchase its own stock exist as to this transaction.

(f) The principles and authorities applicable to the purchases of the Strandberg, Johnson and McGinn stock, heretofore listed, are applicable to this transaction. Under these principles and authorities, the officers and directors participating therein are liable to the Receiver herein.

(g) In addition to the foregoing grounds for recovery on this item, this transaction was fraudulent. Wood was a member of the partnership known as Fairbanks Banking Company. Among the assets transferred by said partnership to the corporation then being organized and by which the pretended excess of assets over liabilities was created in an amount sufficient to entitle Wood to this stock, there were transferred past due and worthless notes and over-valued stocks in excess of such pretended surplus. This pretended surplus had no existence and the corporation received nothing for the stock issued to Wood for which it afterwards paid him $13,000. The officers and directors acquiesced in this transaction and consented to it with full knowledge of these facts. Moreover two of such officers, Wood and Hill, appellees herein, were also members of the partnership and were personally interested adversely to the corporation (F. 22, 23, 24, 25, 35, 40, 47).

(*h*) Officers and directors of a corporation are not permitted to make use of their power or of the corporate property for their own advantage. (See authorities cited under next subdivision.)

III.

THE PURCHASE OF WORTHLESS NOTES.

(*a*) The partnership transferred to the corporation $69,908.94 worth of notes which were at the time past due and worthless and still remain in the hands of the Receiver unpaid and uncollectible, and which were accepted by the officers and directors of the corporation at their face value (F. 22).

(*b*) Of said notes were two executed by the Tanana Electric Company aggregating $27,997.38 which depended for their value solely upon an alleged guarantee of the Scandinavian-American Bank, which guarantee never had any existence in fact and the claim therefor had been repudiated by said last named bank prior to the time said notes were so transferred and accepted, and said repudiation was known to the officers and directors of plaintiff bank. Said notes still remain unpaid. They were accepted and paid for by said officers and directors with knowledge that they depended for their value upon said alleged guarantee alone (F. 23, 24, 57).

(c) Of said past due and worthless notes were also notes aggregating $22,979.99 which said partnership was, at the time of said purchase, carrying on its books in a "Doubtful Account." Of said notes $12,860.61 are still in the hands of the Receiver unpaid and uncollectible (F. 35).

(d) The officers and directors accepted all of said notes with full knowledge on the part of each of them of the existence of the above facts (F. 57).

(e) Appellees Hill and Wood were each personally interested in this matter adversely to the corporation of which they were also officers (F. 57). They should be held to the highest degree of fairness and good faith (see authorities cited below).

(f) This is not an action for rescission of an executed contract, but one against faithless officers and agents for diverting and dissipating the corporate funds.

(g) The purchase and acceptance of these worthless notes at their face value amounted to wilful and fraudulent misconduct by the agents of the corporation, and they are liable for such damages as resulted therefrom. They are also liable for failure to use that degree of care which a prudent man would have used under the circumstances.

—1 Michie on Banks & Banking, pp. 267, 296-297, 367;

Briggs v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;

Wardell v. *Railroad Co.*, 103 U. S. 651, 26 L. ed. 509;

Koehler v. *Hubby*, 67 U. S. 717, 17 L. ed. 339;

Stearns v. *Laurence*, 28 C. C. A. 66;

Trustees v. *Bossieux*, 3 Fed. 817,

Marshal v. *F. & M. Sav. Bk.*, (Va.) 8 S. E. 586, 2 L. R. A. 534;

Ryan v. *Railway Co.*, 21 Kan. 365;

F. & M. Bank v. *Downey*, 53 Cal. 466;

Wilbur v. *Lynde*, 49 Cal. 290;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567;

Bosworth v. *Allen*, (N. Y.) 61 N. E. 163;

Kankakee Woolen Mills Co. v. *Kampe*, 38 Mo. App. 229;

Bundy v. *Jackson*, 24 Fed. 628.

(h) A pretended authorization of the proposed incorporators cannot shield the directors from liability for gross mismanagement against the claims of creditors of an insolvent corporation.

—*Bundy* v. *Jackson*, 24 Fed. 628;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567.

IV.

The Payment of Accrued Interest to the Partnership.

(a) The partnership assets were transferred to the corporation at an agreed valuation, the terms of

which were embodied in a written instrument dated March 16, 1908. The transfer of the loans and discounts listed therein was for a fixed sum therefor (F. 15 and exhibit one to complaint, R. 44-62). This carried with it the right to all interest thereon both accrued and to accrue.

(b) Subsequently, on March 23, 1908, the accrued interest on said loans and discounts was computed to March 15, 1908, in the sum of $39,-642.81, which was placed to the credit of the partnership thereby increasing the liabilities of the corporation. This was acquiesced in by the directors with full knowledge of the facts (F. 36, 57). This was a clear gift to the partners of the funds of the bank.

(c) In this transaction, Hill and Wood were also personally interested adversely to the corporation (F. 57) and again the requirement of good faith and fair dealing previously alluded to was violated.

(d) In this item of accrued interest was also included interest on all of said past due and worthless notes (F. 32).

(e) It would have required almost double the amount of this accrued interest to offset the past due and worthless notes transferred.

(f) The pretended authorization of the proposed stockholders will n o t shield the directors for their gross and fraudulent mismanagement as

to this transaction. It was a wilful and wrongful diversion of the funds of the bank for which they are liable.

—Michie on Banks & Banking, 296, 297;
Coddington v. *Canaday*, (Ind.) 61 N. E. 567;
Bosworth v. *Allen*, (N. Y.) 61 N. E. 163;
Wardell v. *Railroad Co.*, 103 U. S. 651, 26 L. ed. 509;
Ryan v. *Railway Co.*, 21 Kan. 365;
Briggs v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;
Cooper v. *Hill*, 36 C. C. A. 402, 407;
Bundy v. *Jackson*, 24 Fed. 628.

V.

Interest on Money Invested in First National Bank Stock.

(a) The funds of the plaintiff bank were tied up in this stock for an entire year. Said stock was on May 4, 1910, sold by said bank to appellees Wood and McGinn at the original purchase price and pursuant to an option previously given. At the time of said sale the appellees Jesson, Brumbaugh, Wood and McGinn were officers of plaintiff bank. Nothing was ever realized on said investment by plaintiff bank either as a dividend on the stock or as interest on the money invested (F. 55, 59).

(*b*) The carrying of the stock in this manner and the subsequent sale thereof was a misappropriation of the bank's funds and enabled Wood and McGinn to have the use of the bank's funds for a year without cost to them.

(*c*) This is another instance of the officers of the bank safe-guarding their own interests to the prejudice of the bank, and in it their fellow officers acquiesced and are equally involved. The same principle of good faith and fair dealing in the management of corporate funds, heretofore considered, should apply here.

(*d*) The measure of damages is interest on the money so misappropriated at the legal rate of 8%.
—*Cooper* v. *Hill*, 36 C. C. A. 402, 409.

VI.

Interest on Foregoing Items.

(*a*) Appellee is entitled to interest on each of the foregoing items at the legal rate of 8% per annum from the date of each misappropriation of funds.
—*Cooper* v. *Hill*, 36 C. C. A. 402, 409;
Burrows v. *Niblack*, 28 C. C. A. 130;
Bundy v. *Jackson*, 24 Fed. 628.

ARGUMENT.

I.

The Strandberg, Johnson and McGinn Stock Purchases.

(*a*) APPELLANT IS ENTITLED TO JUDGMENT AGAINST APPELLEES, JOHN A. JESSON, JAMES W. HILL AND E. R. PEOPLES, JOINTLY AND SEVERALLY FOR $12,000 FOR THE PURCHASE BY THE BANK OF THE STOCK OF STRANDBERG BROS., EMMA STRANDBERG AND B. E. JOHNSON.

(*b*) APPELLANT IS ENTITLED TO JUDGMENT AGAINST APPELLEES, JOHN A. JESSON, RAY BRUMBAUGH, JOHN A. CLARK, J. A. HEALEY AND GEORGE PRESTON, JOINTLY AND SEVERALLY, FOR $6,000 FOR THE PURCHASE OF THE JOHN L. MCGINN STOCK.

The court's Findings of Fact respecting these transactions in particular, and which are hereinbefore set out in full, are Nos. 32, 33, 44, 45, 48, 49, 50, 51, 52, 53 and 54, the substance of which is as follows:

There was a resolution of the board of directors of said bank requiring monthly statements, showing the condition of the bank, to be presented to said board and in accordance with said resolution there was, during the existence of the bank, presented to the board at each monthly meeting a statement show-

ing the condition of the bank, which statement was examined in detail by the board and by them ordered filed (F. 32). At the meeting of the board on July 13, 1908, while the board was considering a written report showing in detail the condition of the affairs of the bank, the question of refunding to those desirous of giving up their stock in the bank was discussed, and it was the sense of the meeting that any stockholder desirous of giving up his stock should be paid for the same and the stock returned to the treasury of said bank (F. 33). This meeting was held following the taking up of the Wood's stock in the sum of $13,000 on June 30, 1908, which is hereinafter charged as a ground for recovery by the appellant. After taking up the Wood's stock, "frequent and continuous" surrenders of stock were made by the stockholders, amounting in all to thirty-eight different and distinct transactions aggregating $43,000 exclusive of said Wood's stock. Stock so taken back by the bank was charged to treasury stock, and of the same only ten shares of the par value of $1,000 were ever reissued. Said stock surrenders continued down to and including October 25, 1910, when the McGinn stock of the par value of $10,000 was taken up, for which the sum of $6,000 in cash was paid by the bank to McGinn (F. 44).

That on November 18th, 1908, the stock of Strandberg Brothers (100 shares), Emma Strandberg (10 shares) and B. F. Johnson (10 shares), which would aggregate a par value of $12,000 was

taken up by the bank in part payment of a loan that the bank had theretofore made to Strandberg Bros. & Johnson, mining co-partners, and the bank also received at said time the further sum of $4,000 in cash; that said transaction amounted to the taking of stock for a pre-existing debt, rather than a purchase of stock by the directors; and that said directors believed at said time that said loan was precarious, and, in taking said stock in partial satisfaction of said loan, they acted in good faith believing it to be for the best interests of the corporation (F. 45).

That John L. McGinn, the owner of 100 shares of the outstanding stock of said bank of the par value of $10,000 (F. 48), on October 13, 1910, demanded the right as a stockholder to inspect the books and papers of said bank and threatened that, unless such right was immediately granted, he would make application for an order permitting him to do so and also for the appointment of a Receiver; that the directors, fearing that information obtained by such investigation would be used by McGinn in promoting the interests of the First National Bank and that, if litigation was started, it would impair public confidence and perhaps start a run on the bank, authorized the cashier to loan a purchaser sufficient funds to pay for McGinn's stock, one of the directors stating at said time that he had a purchaser who would purchase the same for $6,000, but that it would be necessary for him to borrow the money to do so; that the matter being urgent and a purchaser not immediately avail-

able, the cashier purchased the stock in his own name, gave his note to the bank for the purchase price thereof, and paid to McGinn $6,000, the proceeds of said note, for his 100 shares of stock; that thereafter, on or about October 25, 1910, said cashier, without the knowledge of any of the directors, cancelled his note, charged the amount thereof to the bank and surrendered the stock to the bank, and the stock was thereafter held as treasury stock (F. 49). That appellee Preston on account of sickness did not attend said meeting of the board of directors on October 13, 1908, and knew nothing of the action taken at the meeting of said board.

That from October 14, 1908, to March 13, 1909, the appellees Jesson, Hill and Peoples were members of the board of directors (F. 53), during which time to-wit, in November, 1908, the stock of the Strandbergs and Johnson was taken up; and from January 19, 1910, to October 25, 1910, the appellees Jesson, Brumbaugh, Clark, Healey and Preston were members of the board of directors (F. 53), during which time, to-wit, on October 13, 1910, the McGinn stock was taken up.

The court further found generally as to all stock purchased by the bank as follows:

LI.

"That when stock was so taken back by the corporation, the amount paid therefor was either paid in cash or notes held by the bank were cancelled and surrendered by the stockholders.

"The said bank had no surplus or undivided profits against which the same could be charged."

LII.

"That the taking back of said stock and the payment therefor as aforesaid was illegal, wrongful, and in violation of the laws of the State of Nevada under which said corporation was organized."

LIV.

"That said stock surrenders so made as aforesaid were acquiesced in by said directors, and in some instances were made under their directions and with their express approval."

On these Findings, the court concluded as a matter of law that the appellees Jesson, Hill and Peoples were not liable for the purchase of said $12,000 worth of stock from Strandberg Brothers, Emma Strandberg and B. E. Johnson, and dismissed appellant's action therefor (C. of L. 8, R. 199; Decree 9, R. 203). As to the purchase of the McGinn stock, the court allowed no recovery against appellees Jesson, Brumbaugh, Clark, Healey and Preston, directors at the time of said purchase, and dismissed appellant's action therefor (C. of L. 8, R. 199; Decree 8 and 9, R. 202, 203). Appellant proposed Conclusions of Law Nos. 6 and 10 (R. 205-6) allowing him recovery against said appellees on said items, which were denied.

Appellant excepted to Findings of Fact Nos. 45 and 49 (R. 217-218), and also excepted to the denial

by the court of said proposed Conclusions of Law Nos. 6 and 10 (Exs. 9, 10; R. 220), and also excepted to said dismissal (Exs. 12, 13, 14; R. 220-221). The above matters are assigned as error in Assignments of Error Nos. 1, 2, 9, 10, 12, 13, 14, 15, 16 (R. 227-8, 230-2).

Appellant complains of said Finding of Fact No. 45 to the effect that the purchase of the stock of said Strandberg Brothers, Emma Strandberg and B. E. Johnson amounts to the taking of stock in good faith in partial satisfaction of a pre-existing debt rather than a purchase of stock by the board of directors. The substance of the whole of the testimony upon which said finding was based is preserved in appellant's bill of exceptions (R. 214 to 217) which is as follows:

> " That the substance of the whole of the testimony offered and received on the trial concerning the surrender of said stock of the said Strandberg Brothers, Emma Strandberg and B. E. Johnson was that the said Strandberg Brothers and the said B. E. Johnson were mining copartners and that the said Emma Strandberg was the wife of one of the said Strandbergs, and that on the 5th day of November, 1908, the said Strandberg Brothers were the owners of 100 shares of capital stock of said bank of the par value of $10,000.00 and the said Emma Strandberg was the owner of 10 shares of said stock of the par value of $1,000.00 and the said B. E. Johnson was the owner of 10 shares of said stock of the par value of $1,000.00; that on the 5th day of November, 1908, it was resolved by the

executive committee, the defendant Hill being present as a member thereof, that a loan of $15,-000.00 be made to Strandberg Brothers on the security of their 110 shares of Fairbanks Banking Company stock and notes aggregating $2,-500.00, and that thereafter, on November 12, 1908, at a meeting of the board of directors at which the defendants, J. A. Jesson, E. R. Peoples and James W. Hill were present, the minutes of the meeting of the executive committee held on said November 5, 1908, were read, and on motion duly made and seconded, were approved, ratified and passed as the action of said board. That pursuant to said proceedings a note in the sum of $17,050.00 payable to said bank, was executed by David Strandberg and Strandberg Brothers & Johnson, dated November 5th, 1908, due May 31, 1909, *and the proceeds thereof in the sum of $15,000.00 was placed to the credit of Strandberg Brothers & Johnson in their deposit account*, and the said note of $17,050.00 was secured by the said stock of the said Strandberg Brothers and Johnson as collateral.

" That at a meeting of said executive committee held on November 18, 1908, the defendants, J. A. Jesson and James W. Hill being present as members thereof, the matter of taking over the Strandberg Brothers and Johnson stock was discussed, and the minutes thereof further reciting that 'In taking over this stock the proceeds were to apply to the taking up of the loan of Strandberg Brothers to the bank. It was moved by Ryan, seconded by Jonas, that Mr. J. A. Jesson take up the stock of Strandberg Brothers and Johnson at par on behalf of the bank. Motion carried.' That at a meeting of the

board of directors held on December 12, 1908, at which the defendants James W. Hill, E. R. Peoples and J. A. Jesson were present as members thereof, the minutes of said meeting of the executive committee held on said November 18, 1908, were read, and on motion duly made and seconded were approved, ratified and passed as the action of the board.

" That on November 19, 1908, said note was cancelled and surrendered to the makers thereof, and said bank took up and cancelled the said stock of the said Strandberg Brothers and the said B. E. Johnson, aggregating $11,000.00 as aforesaid, and in addition thereto received from said Strandberg Brothers and Johnson the sum of $4,000.00 in cash. *Said stock was charged to the account of Treasury stock and the deposit account of Strandberg Brothers & Johnson was credited $15,000.00 and subsequently the same was withdrawn by them. Afterwards, on November 25, 1908, the deposit account of Emma Strandberg was credited $1,000, being the par value of her said stock, and her 10 shares of stock cancelled and charged to treasury stock, and the amount so credited to her account was subsequently, to-wit, on February 16, 1909, drawn out by her.* That said board of directors believed, at the time said stock was taken up, that said loan was precarious, and said directors in taking said stock in partial satisfaction of said loan did so in good faith and in the belief that it was for the best interest of said corporation. That in order to get the said Strandberg Brothers & Johnson to take up said note and make said cash payment as aforesaid, it was necessary to include in said settlement the said stock of the said Emma Strandberg."

It will be seen from this testimony that on the 5th day of November, 1908, the executive committee resolved to make a loan to said Strandberg Brothers in the sum of $15,000 on the security of 110 shares of stock of the Fairbanks Banking Company and notes aggregating $2500 and this resolution was afterwards approved by the board of directors on November 12th, 1908. Pursuant to these proceedings a note was executed by David Strandberg and Strandberg Brothers & Johnson, dated November 5th, 1908, due May 31, 1909, and the proceeds thereof in the sum of $15,000 were placed to the credit of Strandberg Brothers & Johnson. Undoubtedly, a corresponding charge was made to the loan account to balance the transaction. It does not definitely appear what day said note was executed, but inasmuch as it was done pursuant to the above proceedings it could not have been at an earlier date than November 12th, 1908. On November 18th, 1908, at the very most but six days after the execution of the note, the executive committee, at a meeting at which said Jesson and Hill were present as members, discussed the matter of taking over said stock and decided that in so doing "the proceeds were to apply to the taking up of the loan of Strandberg Brothers to the bank," and upon motion it was decided "to take up the stock of Strandberg Brothers & Johnson at par on behalf of the bank."

On November 19, 1908, at the most but seven days after the execution of said note and the placing of the proceeds thereof to the credit of Strandberg

Brothers & Johnson, said note was cancelled and surrendered to the maker thereof, and the stock of the said Strandberg Brothers & Johnson aggregating $11,000 together with the sum of $4,000 in cash was received by the bank. *The stock was charged to the treasury account, and the deposit account of Strandberg Brothers & Johnson was credited with $15,000, which was subsequently withdrawn by them.* By these means Strandberg Brothers & Johnson got $15,000.00 of the bank's funds and also their cancelled note in the principal sum of $15,000.00. All they ever gave up in return for these items was $4,000.00 in cash and stock of the par value of $11,000.00, aggregating $15,000.00 in all. The proceeds of the note having been credited to them, there must have been a corresponding charge to them when the note was cancelled, leaving the remaining credit to them to arise out of said stock and cash.

Afterwards on November 25th, 1908, Emma Strandberg surrendered her 10 shares of stock and received a credit of $1000 which was subsequently drawn out by her.

The above action of the executive committee respecting the taking up of said stock was approved by the board of directors on December 12th, 1908, at which meeting the appellees Hill, Peoples and Jesson were present as members thereof. That said directors acquiesced in said stock purchase is found by the court in Finding No. 54.

Said stock purchase was in full accord with the previous dealings of the bank. After the purchase of the stock of R. C. Wood in the sum of $13,000 on June 30th, 1908, up to and including November 25th, 1908, a period of approximately five months, said bank took up $28,000 of its stock (F. 30 and 53), or a total of $41,000.00 within nine months after commencing business. The court found that after the said purchase of the Wood's stock of $13,000, "frequent and continuous surrenders of its stock were made by its stock holders" (F. 44). The purchase of the Strandberg and Johnson stock was in keeping with and pursuant to the policy of the bank expressed at the meeting of the board of directors on July 13, 1908, "that any stockholder desirous of giving up the stock be paid for the same and the stock returned to the treasury of said bank" (F. 33).

In the light of these proceedings the claim now made that the board of directors, within a week after making said loan realized that the loan was "precarious" and that said purchase was made in partial satisfaction of a "pre-existing debt," was an afterthought. The proceeds of said note, $15,000, were placed to the credit of said Strandberg Brothers & Johnson. At the time the stock was taken back, the same was charged to the account of treasury stock and their deposit account was credited with $15,000, which was subsequently withdrawn. If the purchase was made for the purpose of cancelling said note why was the $15,000 placed to their credit and they per-

mitted to withdraw the same? This credit of $15,000 was derived from the $4,000 cash and the $11,000 stock surrender. If this stock and cash were used by the bank for the purpose of taking up the note, the same became the property of the bank and the proceeds thereof would not have been placed to the credit of Strandberg Brothers & Johnson and *subsequently withdrawn by them.*

Just how the bookkeeping of these transactions was handled does not appear in detail. The net result was two credits to Strandberg Brothers & Johnson of $15,000.00 each, one of which was the proceeds of said note, and the other the stock ($11,000.00) and cash ($4,000.00). The stock, the court found, was charged to "Treasury Stock." The cash received must have been charged to "Cash." When the note was cancelled it was necessary to balance the loan account by a credit thereto, and the only proper account for the corresponding charge would be that of Strandberg Brothers & Johnson. This would then leave to their credit the $15,000 to be subsequently withdrawn by them in cash, and the stock and note entries completely balanced.

On the theory that said stock and said $4,000 in cash took up said loan which had so suddenly become precarious, wherein was the bank benefited? The note was not due until May 31st following. The loan was made on the security of said $11,000 worth of stock and notes aggregating $2,500. This security was just as available on May 31st as on November

19th. Strandberg Brothers & Johnson were miners. The credit of such classes of men in the Fairbanks region may have been fluctuating; but there was only an unsecured margin of $1,500 to be affected by these fluctuations. It further appears that in order to get said cash of $4,000 it was also necessary to include the taking up of the stock of Emma Strandberg in the additional sum of $1,000, and this sum was subsequently paid to her. The bank then in reality received but $3,000 in cash to apply toward the taking up of this note, which, together with the $11,000 worth of stock belonging to Strandberg Brothers & Johnson, aggregates $14,000, assuming that the stock was worth par. In return for this the bank surrendered said note of $15,000 thereby electing to take a loss of $1,000 within one week after the loan was made, while it could have lost but the unsecured balance of $1,500, if it had waited until the note matured. If the bank had carried the loan to its maturity, it would not have lost to exceed $500 more than it did lose by accepting the stock and cash aforesaid in payment of the note on November 19th. The capital of the bank was already impaired by previous purchases of its stock by the bank; yet these directors "in good faith" further impaired it to the extent of $12,000.00 to save a possible increased loss of $500 six months afterwards. If the entire $2,500 worth of collateral notes were worthless, the bank would have been no worse off in that respect when the Strandberg Brothers & Johnson note became due. Of course, it would not have received the cash payment

of $3,000: neither would its capital have suffered the further impairment of $12,000. The proceeds of the stock would have remained in its possession for the benefit of its creditors instead of being withdrawn by favored stockholders. With all respect for the judgment of the lower court, it is submitted that this transaction was not had in good faith and for the purpose of satisfying a pre-existing debt. It was simply a blind to cover up an illegal transaction. The debt came into existence contemporaneously with the pledging of the stock as collateral and was therefore not pre-existing.

When said stock was taken back before the maturity of the loan which it was pledged to secure, it can not in fairness and good reason be said to have been taken back in payment of a pre-existing debt.

Regardless, however, of the good faith of the directors or the question of pre-existing indebtedness, the fact remains as found by the court in Finding 52 that the taking back of this stock was "illegal, wrongful and in violation of the laws of the State of Nevada under which said corporation was organized." Whether or not the debt was pre-existing, or whether or not the directors acted in good faith, the transaction was prohibited by law. The law applicable to this matter will be considered later in connection with the purchase of the McGinn stock.

Appellant further complains of Finding of Fact No. 49 relating to the purchase of the McGinn stock.

The testimony upon which this finding of fact is based clearly discloses that the cashier who conducted this transaction was acting therein as the agent of the bank and that, although the purchase was made in his name, it was made for the bank; hence when the cashier surrendered this stock to the bank after such purchase he only consummated the real transaction.

The substance of the testimony upon which this finding is based is as follows:

> " That the substance of the whole of the testimony introduced and received on the trial of said cause respecting the matter of the surrender of said stock of said McGinn is as follows, to-wit:
>
> " That, at the time when the defendants George Preston, J. A. Healey. and John A. Clark were directors of the said Washington-Alaska Bank and about the month of October, 1910, and prior to the twelfth day of said month, John L. McGinn, who had theretofore been a director of said Washington-Alaska Bank, formerly Fairbanks Banking Company, and who had for a number of years been attorney for said bank, and was the owner of 100 shares of the capital stock thereof, notified the vice-president and manager of said bank, J. Albert Jackson, that he intended to exercise his rights as a stockholder to examine all the affairs of said bank and would do so, and further stated that he would sell his stock for the sum of $6,000.00. That the stock of said John L. McGinn was of the par value of $10,000.00; that he had received $2,000.00 in dividends and that he was willing to

sell said stock for the sum of $6,000.00; that he was one of the owners of the First National Bank of Fairbanks, having recently acquired that property, and that he needed all the money he could get; and that, as the First National Bank was a rival bank of the Washington-Alaska Bank, he did not desire to have any stock in the said Washington-Alaska Bank.

" That an intense rivalry existed between said banks at said time, and there was keen competition in the purchase of gold-dust and the acquiring of banking business, and said John L. McGinn notified said J. Albert Jackson, vice-president and manager of the Washington-Alaska Bank, that he would exercise his right as a stockholder to demand an inspection of the books of said Washington-Alaska Bank and other records, thus enabling him to secure information respecting the clients, customers, creditors and debtors of the said Washington-Alaska Bank that could be by him used to the advantage of said First National Bank and greatly to the detriment of said Washington-Alaska Bank.

" That said demand and said statements were by said J. Albert Jackson reported to the board of directors, or the greater part thereof, and an informal discussion was had by a number of said directors as to what was advisable to be done; that it was also reported by said vice-president and manager, J. Albert Jackson, that said McGinn had threatened that if his demand for an inspection of the books and records of said bank was not complied with he would bring a suit against the said Washington-Alaska Bank as a stockholder thereof, asking for the appointment of a receiver, on the ground that, as a stockholder he was refused information that he

was entitled to receive, and on the further ground that the officers of said Washington-Alaska Bank were mismanaging said bank, in that they were paying more for gold-dust than they were justified in paying, and for other acts.

" That D. H. Jonas, one of the directors of said bank, stated to the directors, including said defendants, that he was satisfied that he could find a purchaser for said stock at the said price of $6,000.00; that thereafter and on the 12th day of October, 1910, at the regular monthly meeting of the directors of the Washington-Alaska Bank, the matter was considered by the board of directors and it was then reported by said D. H. Jonas, that he had not been able to see the prospective purchaser, but that he was satisfied that prospective purchaser would take said stock and would probably require a loan from the bank, as he did not at that time have sufficient money to make such purchase; that it was again reported by the vice-president and manager that said John L. McGinn was insistent on said matter and demanded that it be closed at once.

" That at said meeting of 12th October, 1910, it was moved, seconded and duly carried that 'The officers extend a loan to the party to whom McGinn would sell and retain the stock in the bank as collateral.' That it was reported at the said meeting by said D. H. Jonas that it might be some days before the prospective purchaser could be reached, and it was then decided by said board of directors, that, if it became necessary to prevent action being taken by said John L. McGinn, F. W. Hawkins, the cashier of the bank, be loaned the money necessary to pay for the stock, to-wit, the sum of $6,000.00, and that said

stock be held as collateral security for said loan, and that, when the prospective purchaser could be communicated with, a new loan could be made to said purchaser and the stock be issued to said purchaser and be held by the bank as collateral security for such new loan.

" That, in accordance with said agreement, said F. W. Hawkins borrowed from the said bank the sum of $6,000.00 which he paid to said John L. McGinn for said stock and said stock was assigned by the said McGinn in blank and said F. W. Hawkins executed his note to said bank for said sum.

" That thereafter, and without the knowledge, consent or approval of the board of directors, or of said defendants, as members of said board, said F. W. Hawkins cancelled his note and returned said stock to the bank, and said defendants knew nothing of said transaction until after said bank was closed.

" That the directors of said Washington-Alaska Bank had with them employees whom they trusted and who were under bond, and who had theretofore, so far as said defendants had knowledge or information, strictly performed the orders given to them by the board of directors; that the board of directors had no information concerning the subsequent action of said F. W. Hawkins with regard to said stock until after the suspension of said Washington-Alaska Bank.

" That said directors refused in behalf of said bank to purchase said stock from said John L. McGinn, and did not purchase said stock, and the surrender of said note by said F. W. Hawkins was wrongful and without authority.

"That no information was furnished to said board of directors that would lead them to believe that the officers of said bank had done or performed any act or thing contrary to the instructions given, and said defendants were never informed that the purchaser whom said D. H. Jonas claimed to be available had not purchased said stock.

"That at the time it was voted to loan said money to the purchaser of said stock, said stock was considered by said board of directors to be worth a sum in excess of $6,000.00 and said loan was considered a perfectly safe loan, and said directors had no reason to believe that said bank was not in a perfectly solvent condition or that the McGinn stock was not worth the full sum of $6,000.00.

"That had said McGinn been permitted the rights claimed by him as a stockholder and examined into the affairs of said bank, with a view of ascertaining its clients, customers, creditors and debtors, it would have caused said bank great irreparable damage and would have resulted to the benefit and advantage of the First National Bank, of which said John L. McGinn was one of the principal owners."

The facts clearly disclose that the cashier was acting as agent of the bank. He took up the stock with the funds of the bank, for the convenience of the bank, and not as an investment of his own. He held it simply as a trustee for the bank, for the purpose of disguising the transaction, until someone could be found who would take the stock, which was never done. When he subsequently cancelled his note

and delivered the stock to the bank, he did nothing more than complete the real transaction. The legal title to the stock never was in him. None of the personal funds of the cashier were invested, and it never was intended by this transaction to hold him as the purchaser of the stock. McGinn gave up his stock on the 13th of October, 1910, and the cashier on the 25th day of October, but twelve days afterwards, cancelled his note, charged the amount thereof to the bank, surrendered the stock to the bank, and the said stock was thereafter held as treasury stock.

This transaction ended a long line of stock purchases aggregating $56,000. McGinn and other favored stockholders got their money, and less than three months later this financial delirium which has been called a bank was turned over to receivers. The general course of the bank's dealing in the matter of stock surrenders, conducted with the approval of its directors, makes a farce of their whimsical resolutions on the subject, and a pretense of their claims of good faith as to some particular transaction.

A transaction almost identical to the McGinn purchase was presented to the United States District Court for the Northern District of Texas, *In re S. P. Smith Lumber Company*, 132 Fed. 618. In that case one Smith and one Manafee owned substantially all the shares of a corporation's stock and they together with one other constituted the board of directors. The affairs of the company being in an unsatisfactory and precarious condition, Manafee was anxious to dispose of his interests in the company and insisted that

Smith buy him out and as a means for accomplishing his purpose threatened Smith with a receivership. In order to "get rid of him" Smith bought him out by transferring to him certain promissory obligations of the company together with a sum of money from the funds of the company and took the transfer of the stock to himself. The court said:

> " The Manafee shares were transferred to S. P. Smith but the consideration for the transfer flowed from the company. In view of this fact the transaction was no doubt a purchase by the company of its own shares."

The case at bar is much stronger than the *Smith* case, because in it the purchase was made by the cashier with the funds of the bank, at the request of the bank, and for the convenience of the bank.

In *Shuey* v. *Holmes*, (Wash.) 54 Pac. 540, Shuey as receiver of a bank sued Holmes to recover on a note given by Holmes to the bank. It appeared that it was represented to Holmes by the bank that it had come into possession of some of its own stock, including the shares in question, which it was contrary to law for it to hold, and at its request Holmes took 30 shares of the stock temporarily and gave his note therefor until the stock could be sold, and paid for by an actual purchaser. As an accommodation to the bank Holmes took the stock and executed and delivered the note sued on. It was held that by such transaction Holmes incurred no liability to the said bank on said note.

The court having found (F. 52) that the taking back of the Strandberg, Johnson and McGinn shares of stock, and the payment therefor, was illegal wrongful and in violation of the laws of the State of Nevada, judgment should be entered in favor of the appellant on these transactions against the directors and officers participating in such transaction. One can not shield himself against the consequences of a violation of positive law under the cloak of expediency and good faith. If the court believes that Hawkins really was the purchaser of the stock and did not buy it as the agent of the bank, the fact still remains that he made the purchase with the funds of the bank and with the approval of the directors. In *Green* v. *Hedenberg*, (Ill.) 42 N. E. 851, a group of stockholders sold to another group of stockholders and others 864 shares of the capital stock of a corporation. The officers of said corporation permitted $15,200 of corporate funds to be used in making part payment on the purchase. Although it was found that the stock was purchased for the individuals and not for the corporation, still the court held that the officers, having advanced corporate funds to the vendees of the stock in order to enable them to purchase, were personally liable to a creditor of the corporation, and ordered that they pay.

The general right of a corporation to purchase its own stock has been frequently before the courts and they are divided upon the question. The courts of England have established and rigidly adhered to

the rule that a corporation can not become the purchaser of its own shares. (Cook on Corporations, Sec. 309.) In the United States where such right has been allowed it is generally derived from statute; or, in the absence of a statute positively prohibiting it, the offending corporation was acting within some recognized exception of the rule prohibiting it, as where for instance it was not prejudicial to the rights of creditors or stockholders, or where the purchase was not made out of the capital but out of the surplus or undivided profits. In the case at bar the purchase was not only made out of the capital of the bank, or with the money of the depositors, but was prohibited by law. The bank had neither surplus nor undivided profits against which the same could be charged (F. 51). It was hopelessly insolvent when it commenced buying up its outstanding stock, as will be seen by the following review of the facts found by the court:

In addition to this frequent and continuous depletion of its assets by said stock purchases, the court found that from its inception the bank carried as an asset past due paper, taken over from the partnership which the bank succeeded, and which is now in the hands of the receiver "unpaid and uncollectible" aggregating $69,908.94 (F. 32), included in which are the notes of the Tanana Electric Company of $27,997.38, which were at all times utterly worthless (F. 33), and that the bank always had, and still had at the time this case was tried below, $341,949 of its assets, or $135,949 more than its maximum outstand-

ing capital, tied up in the capital stock of the Gold Bar Lumber Company (F.39), which said investment was eating itself up in the purchase and repair of equipment and never earning a dollar of profit (F. 40); that on March 23, 1908, its assets were further depleted by a gift as a credit to the partnership composed of Barnette, Hill and Wood of $39,642.81, accrued interest on the loans taken over from said partnership on the organization of the corporation bank (F.36), of which loans the Receiver now has the above mentioned $69,908.94, which are uncollectible. At the time the corporation took over the partnership, the partnership assets were accepted at a valuation of $790,940.31 and its liabilities at $538,940.31, leaving an apparent excess of $252,000 belonging to said partners (F. 15) for which they were issued stock to the amount of $52,000 and the remaining $200,000 placed to the credit of Barnette and subsequently drawn out by him in cash (F. 45). Adding together these items of past due and uncollectible notes, the credit to the partnership of said accrued interest, stock issued to partnership, and the Barnette credit item, they total $361,551.75, which immediately became additional liabilities of the corporation, and ran its total liabilities up to $900,492.06, or $109,551.75 in excess of its resources counting Gold Bar Lumber Company stock as of full value. This was the real condition of the bank when it commenced business on March 16, 1908, with a "subscribed and outstanding capital stock of $206,000, only a small portion of which was paid in cash" (F. 39). On the following

June 30th, it commenced buying in its outstanding capital stock, although all of it but $96,448.25 was already wiped out by said *initial* liabilities, and kept it up until $56,000 worth was bought in and paid for out of the funds of the bank; and the Receiver still owes $470,000 in excess of the value of its assets now in his hands (F. 66).

The reason for denying a corporation the right to repurchase its own stock is generally grounded upon the principle either that the capital is a trust fund upon which the creditors have a prior claim over stockholders, or that creditors have a right to rely upon some added liability which attaches to one owning stock over and above the amount invested in such stock. In either case it is considered contrary to sound public policy to permit the stockholders to divide among themselves the fund to which the creditors look for the payment of their claims. Again it is prejudicial to the other stockholders. It is highly inequitable to allow one stockholder, without the consent of the others, to withdraw his share of the common venture leaving all the others to risk what they have ventured in a joint enterprise. If the offending corporation had such right and exercised it to the full limit, all of its capital could be distributed to its stockholders, or certain favorite ones, leaving the creditors and other stockholders only its promises to pay. Of course the right to re-issue the stock would be existent but what could that avail when its assets have been depleted or consumed? Stock which merely

evidenced a liability to assessment would not avail creditors much in satisfying their claims.

In his work on Corporations, section 311 (6th ed.), Mr. Cook, after alluding to the differences of opinion in the American courts as to the rights of a corporation to purchase its stock, says:

> " The objection usually made to allowing a corporation to purchase its own stock is that thereby the corporate funds are expended and no property is received by the corporation, except the right to resell. This objection is merely a limit to the power of the corporation to purchase. In Illinois, the state where the right of the corporation to make such purchases is most clearly and decisively established, *the collateral principle* that such purchases are to be declared illegal and voidable at the instance of corporate creditors who are injured thereby is distinctly stated and rigidly applied. If the corporation is insolvent at the time of the purchase, it is clearly an invalid transaction, and will be set aside. The rule goes still further, and declares that if a corporation, by a purchase of shares of its own capital stock, thereby reduces its actual assets below its capital stock and debts, or if the actual assets at that time are less than the capital stock and debts, such purchase may be set aside, and the *guilty corporate officers*, as well as the vendor of the stock, may be rendered liable thereon at the instance of a corporate creditor."

In Thompson on Corporations, section 1548, it is said:

"For a corporation to repurchase its shares at a price which the subscriber has paid for them is simply to distribute the trust fund of creditors, hereafter spoken of, a m o n g those from whom it was originally collected. That this can not be done as against creditors, if it has any, is plain. That it can not be done as against shareholders is equally plain. In the absence of special circumstances, such as rendering allowable compromises, it is safe to say that this can not be done as against other shareholders, in the absence of statutory authorization, *without unanimous consent*. For this reason, *the general rule is that a corporation can not purchase and hold its own shares.*"

Again at section 2054, the same author says:

"The capital stock of a corporation being a trust fund for creditors, *the general rule, in the absence of an enabling statute, is, that a corporation cannot employ its funds in purchasing its own shares*, thus distributing its capital among its shareholders to the manifest detriment of its creditors. As was observed by Lord HERSCHEL, L. C.: 'Stringent precautions to prevent the reduction of the capital of a limited company without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale,' and if it were otherwise, the result would be that the shareholders would receive back the money subscribed, and there would thus pass into their pockets what before existed in the form of cash in the coffers of the company, or of buildings, machinery, or stocks available to meet the demands of the creditors. And he also held that the purchase of shares for the purpose of reselling would be a trafficing or dealing in

shares and unlawful. *The rule which forbids a corporation thus to employ its funds rises to the grade of a rule of public policy;* and is so strong that, although power is conferred upon the company to deal in the shares of joint-stock companies generally, this does not authorize it to deal in its own shares. *It is immaterial whether the transfer is made to the company itself, or to a nominee of the directors to hold in trust for the company; in the latter case, equally with the former, it is invalid.*"

In Morawetz on the Law of Private Corporations, section 112, it is said:

" A purchase by a corporation of shares of its own stock in effect amounts to a withdrawal of the shareholder whose shares are purchased from membership and a repayment of his proportionate share of the company's assets. There is no substitution of membership under these circumstances as in case of a purchase and transfer of shares of a third person, but the members of the company and the amount of its capital are actually diminished. Whatever a transaction of this character may be called in legal phraseology, it is clear that it really involves an alteration of the company's constitution, just as the withdrawal of a member of a co-partnership with his proportionate share of the joint funds involves an alteration of the constitution of a co-partnership. The amount of the company's assets and the number of its shareholders are diminished. Every continuing shareholder is injured by the reduction of the fund contributed for the common venture; and the creditors who have trusted the company upon the security of

the capital originally subscribed, or who are entitled to expect that amount of security, are entitled to complain.

" It is no answer to say that shares having a market value must be regarded like any other personal property, and that no person is injured if a solvent corporation in good faith purchases shares in itself at their market value, inasmuch as the shares so purchased are property in the hands of the company and may at any time be reissued or sold. No verbiage can disguise the fact that a purchase by a corporation of shares of itself really amounts to a reduction of the company's assets and that the shares purchased in fact remain extinguished, at least until the reissue has taken place. The fact that such a transaction may not necessarily be injurious to any person is not a sufficient reason for supporting it. *It is contrary to the fundamental principle of the stockholders and is condemned by the plainest dictates of sound policy. To allow the directors to exercise such a power would be a fruitful source of unfairness, mismanagement and corruption.* It is for these reasons that a shareholder can not be allowed to withdraw from the corporation with his proportionate amount of capital either by a release and cancellation before the shares have been paid up or by a purchase of the shares with the company's funds."

In *Thompson* v. *Reno Savings Bank*, 7 Pac. 68, decided by the Nevada Court, the articles of incorporation fixed the capital of the bank at $100,000.00 but it was agreed between the stockholders that only thirty per cent of the stock need be paid in. One Lake was a stockholder and upon the failure of the bank,

suit was brought against him by the receiver for the remaining seventy per cent due on his stock. He interposed this agreement as a defense. The court, after holding that the capital stock of a corporation, organized under the laws of the state for the purpose of banking, is the amount paid or promised to be paid for the purpose of incorporation, and it is a "fixed sum, not to be increased or diminished, except in the mode permitted by the statute," characterizes such an arrangement as one "made in defiance of the statute under which the bank was incorporated," and then quotes section 3543 of the Compiled Laws, as follows:

> " It shall not be lawful for the directors to divide, withdraw or in any way pay to the stockholders or any of them, any part of the capital stock, nor to reduce the amount of the same."

The decision last cited ought to settle this litigation in favor of appellant. It is a decision of the Nevada Supreme Court construing the identical law under which the corporation for which appellant is Receiver was organized. The transaction amounted to a division of the capital among the stockholders in the case at bar. Nevada is the parent state of this corporation and in construing its statutes the decisions of its Supreme Court are controlling. (*Fairfield* v. *County of Gallatin*, 100 U. S. 50). When a person becomes a member of a corporation organized under the laws of another state, he consents to be governed by the general corporation laws of that

state and his rights and liabilities are tested and determined by such laws. (*Giesen* v. *London etc. Co.*, 102 Fed. 584, 42 C. C. A. 515; *Silver Mines* v. *Brown*, 58 Fed. 644, 7 C. C. A. 412; *Relfe* v. *Rundle*, 103 U. S. 222, 26 L. ed. 337; *Railway Co.* v. *Gebbard*, 109 U. S. 527.) In the Nevada case, above cited, there was an agreement to surrender a p a r t of the capital agreed to be paid, which was condemned. In the case at bar, there was surrendered a part of the active capital—the very corpus of the bank—and it for more cogent reasons should not be tolerated.

In the case of *Smith Lumber Company*, 132 Fed. 618, heretofore referred to, the court said:

> " In the United States, I take it, the weight of authority upholds the right of a corporation, *in the absence of a statutory prohibition*, to become the purchaser of shares of its own stock; *but the courts which have most distinctly announced and upheld this doctrine have most definitely held to and rigidly enforced the collateral principle that a corporation can not become such purchaser when it results in a fraud upon the rights of, or injury or loss to, the creditors of the corporation.* The danger of fraud being perpetrated upon, or injury or loss resulting to the creditors was one of the potent reasons moving the courts of England to establish and adhere to the rule that a corporation can not become the purchaser of its own shares. In view of the contrary doctrine obtaining in most of the courts of this country, the safety of the creditors of the corporation lies in the recognition and enforcement of the *collateral principle* above set forth.

Were it not for the existence of this principle, creditors of corporations would occupy a most hazardous and precarious position."

In *Lowe* v. *Pioneer Threshing Company*, 70 Fed. 646, the United States Circuit Court for the District of Minnesota allowed an injunction against carrying out a resolution adopted at a stockholders' meeting to purchase the stock of certain stockholders by the corporation by transferring certain property and assets of the corporation therefor, where to do so would be in fraud of the rights of the minority protesting stockholders, even though the tendency in Minnesota was to permit the purchase of its stock by a corporation in the absence of charter prohibition or statute forbidding it, at least if made out of the profits derived from the business of the corporation.

In *Tolman* v. *N. M. & D. Mica Company*, (Dak.) 22 N. W. 505, a contract for the repurchase of shares of stock was held to be in violation of the laws of Colorado under which the corporation was organized, which laws forbid corporations to use any of their funds for the purchase of stock in their own company or corporation except such as may be forfeited for non-payment of assessments. In this case it was alleged that the contract of repurchase was made in pursuance and fulfillment of a contract previously made by the company for the purchase from plaintiff's assignor of his interest in a certain Mica mine, a part of the consideration for which purchase being said shares of stock so contracted to be repurchased. It was held that the contract was illegal.

In *Vercoutre* v. *Golden State Land Company*, (Cal.) 48 Pac. 375, the defendant company had a by-law to the effect that a stockholder desiring to surrender his stock and withdraw from the corporation might do so upon giving the required notice and thereupon on surrender of his stock be entitled to receive from the corporation the surrender value thereof. The Fairbanks Banking Company had a very similar by-law (F. 42). Vercoutre sought to surrender his stock under this by-law and the court said:

> " The further finding that article 16 of the by-laws aforesaid was illegal and void necessarily followed. Inasmuch as under the provisions of sections 301 and 354, Civil Code, the corporation can adopt only such laws as are not inconsistent with the constitution or existing laws of this state, it follows that any regulation or rule that it may adopt under the form of a by-law which contravenes the provisions of an existing law is invalid and has none of the elements of a by-law.
>
> " Section 309 of the Civil Code forbids the withdrawal or payment to the stockholders of any part of the capital stock of a corporation except upon its dissolution, or at the expiration of its term of existence."

In *Kassler* v. *Kyle*, (Col.) 65 Pac. 34, the stockholders adopted a resolution reducing the amount of the capital stock in a bank one-half and providing that certificates of deposit should issue to the stockholders in payment for the stock surrendered by them. The court said:

> "Independently of statute, except in the instance thereby expressly permitted, banking corporations are inhibited from purchasing their own stock. To the stockholders of bank stock certain liabilities attach in favor of the general creditors. If a bank may purchase its own stock, this liability can be avoided, its capital depleted and there would be no security to the depositors except in the bank itself."

In each of the foregoing cases the transactions herein complained of are unqualifiedly denounced as illegal just as the lower court declared them to be in the case at bar. They were illegal because prohibited by statute as well as because they contravene public policy. In the case at bar, they are found by the court to violate the laws of Nevada. Ought not, then, the directors with whose approval and under whose direction these illegal acts were done be held liable for such wrongful diversion of funds? If these purchases had been made out of surplus or undivided profits they would have been no less illegal, but injury to creditors might not have resulted. This bank was in a state of insolvency from its inception. Within four months after it commenced business it purchased Wood's stock and paid him $13,000 therefor, and there were then no profits or surplus against which the same could be charged. Frequent and continuous purchases were made, in all aggregating $56,000 down to within two months and a half of the time the bank ceased to do business, and, as found by the court, the bank had no surplus or undivided prof-

its against which any of the same could be charged. It must therefore have been in a continuous state of insolvency.

In further support of the principle that a corporation can not buy its own shares of stock where prohibited by statute, or where it has neither surplus nor undivided profits against which the same can be charged, see:

Martin v. *Zellerbach*, 38 Cal. 307;
First Nat. Bank v. *Salem etc. Co.*, 39 Fed. 89, 95-97;
Commissioner v. *Thayer*, 94 U. S. 631, 643, 24 L. ed. 133;
Bank v. *Lanier*, 11 Wall. 369, 20 L. ed. 172;
Hall v. *Alabama etc. Co.*, 143 Ala. 468, 39 So. 285;
Currier v. *Slate Co.*, 56 N. H. 262;
Hamor v. *Taylor, Rice Eng. Co.*, 84 Fed. 187;
Farrington v. *Tennessee*, 95 U. S. 679, 686;
In re Brocking Mfg. Co., (Me.) 35 Atl. 1012;
Tait v. *Pigott*, (Wash.) 80 Pac. 172;
Adams & Westlake Co. v. *Deyette*, 5 S. D. 418, 425, 8 S. D. 127;
German Sav. Bank v. *Wulfekuhler*, 19 Kan. 60;
Hall v. *Henderson*, 126 Ala. 449, 28 So. 531;
Crandall v. *Lincoln*, 52 Conn. 73;
Com. Nat. Bank v. *Burch*, 141 Ill. 519, 32 N. E. 420;

Clapp v. *Peterson*, 104 Ill. 26;
Bank v. *Ross*, 68 Conn. 29;
Rogers v. *Ogden etc.*, 30 Utah 188;
New Eng. Tr. Co. v. *Abbott*, 162 Mass. 148;
Blalock v. *Kernerville Mfg. Co.*, 110 N. C. 99;
Van Brocklin v. *Queen etc. Co.*, 19 Wash. 552;
Green v. *Hedenberg*, (Ill.) 42 N. E. 851.

The lower court undertook to excuse the directors from liability on the Strandberg transaction because said surrender was made in payment of a pre-existing debt, and from liability on the McGinn transaction because thereby the bank was being relieved of a dissatisfied and annoying stockholder; but the laws of the State of Nevada did not permit a bank to buy back its own shares for such reasons; otherwise the court could not have found that the transactions were in violation of said law.

On the trial below, reliance was had upon the cases of *In re Castle Braid Co.*, 145 Fed. 224; *Copper Bell Mining Company* v. *Costello*, (Ariz.) 95 Pac. 94, and *Barto* v. *Nix*, (Wash.) 46 Pac. 1033; but neither of these cases sustain the position of the lower court. In the *Castle Braid Company* case the contract of purchase was made with the assent of all the stockholders and it did not appear that the corporation was insolvent at the time. Nor was the purchase considered by the court to be prohibited by the Statutes of New York. In that case the court said:

"The purchase of stock of the corporation by the corporation from the stockholders is not prohibited or forbidden, *but payment therefor from the capital may be and probably is.*"

In the *Copper Bell Mining Company* case, *supra*, Costello brought an action in Arizona to foreclose two mortgages on property of the corporation. The *Copper Bell Mining Company* was originally incorporated under the laws of the State of West Virginia. Subsequently a new corporation bearing the same name was organized under the laws of Arizona which took over the West Virginia corporation. It appears that one Gleeson was the owner of 8000 shares, being a small amount of the stock of the corporation, and was its superintendent and manager. His management of the company was believed to be injurious, and in order to get rid of him the officers of the company on behalf of the company purchased his stock. In order to make a part cash payment they borrowed $15,100 from Costello secured by a first mortgage on the property of the corporation and executed to Gleeson a second mortgage thereon for the balance of the purchase price, which mortgage he assigned to Costello. In defense the corporation pleaded, among other things, that its act in executing the mortgage was *ultra vires* and that at said time the corporation was insolvent. The court said (95 Pac. 98):

"In this country, while some states forbid it, the better rule seems to be that *in the absence of statutory requirement and where there is no*

statutory liability on the stock, a solvent corporation may in good faith purchase its own stock subject to the rights of creditors upon a showing that they have been injured thereby, and in some instances of non-assenting stockholders, to have such purchase declared illegal. In the case before us we think the purchase by the company of its stock was a valid one as against the corporation. It was done in the discretion of the officers of the company in good faith, and in the exercise of their control of the affairs of the company for the purpose of getting rid of a superintendent, the owner of a small amount of stock, whose management of the company was believed to be injurious. *At the time of the purchase there is no evidence that the company was insolvent*, or that any of the officers or directors of the company, or any of its stockholders, had any reason to so believe, or that Costello or Reilly had any knowledge of the subject whatever. * * * *In this case no proof was offered of any statute of West Virginia on the subject, and no Arizona statute prohibits such purchase. In the absence of any statute prohibiting the purchase by a corporation of its own stock, such purchase is a transaction not per se void; but its validity depends upon the circumstances of the case.* The transaction might in some instances be avoided by stockholders who did not assent, if injured. *It might be avoided by creditors who were injured.* But there are no such facts in the record before us of the condition of the company at the time when the purchase of this stock was made as would warrant us in declaring the purchase illegal at the instance of the corporation."

Subsequently the same case came up again before the court and the court said (100 Pac. 807, 810):

> " *We are clearly of the opinion that a purchase by the West Virginia Company of its own stock made with Costello's knowledge could not be upheld if existing creditors were in fact injured thereby.* The difficulty with the appellant's position is that the record does not bear him out in his assumption that the creditors were injured by such purchase. The trial court found that at the time of the execution of the notes and mortgages the West Virginia Company had assets largely in excess of its indebtedness."

In each of the last two cases, the court was particular to point out the absence of any statute forbidding the purchase as well as the fact that the corporation had assets in excess of its indebtedness and that it resulted in no loss to creditors. In the case at bar, the laws of Nevada prohibited the purchases and the same were made out of the bank's capital and resulted in loss to the creditors.

In *Barto* v. *Nix*, *supra*, after the bank had purchased the stock, it re-issued it to defendants. Suit was brought by the Receiver to collect an assessment upon the stock, and defendants contended that the bank had no authority to take back the stock and reissue it. While the court intimated that a corporation had authority to take back its stock in payment of the indebtedness of one of its stockholders, this was only said by way of argument in answer to defend-

ants' contention. The whole matter was finally disposed of by saying:

> "But, whether it did or did not (have such authority), these defendants, who were the managers of the bank, cannot defend upon the ground that what was done was not authorized by the law." (46 Pac. 1034.)

It will be seen that the Washington Court did not consider it essential to its decision whether or not a bank could take back its stock in payment of a debt due from its stockholders.

For other stock purchases made by the bank, aggregating $21,000, the lower court entered judgment against the officers and directors participating therein (Decree, R. 200-202). All purchases were condemned by the court as illegal, wrongful and in violation of law, and recovery for all should have been included in the Decree.

These appellees purchased for the bank shares of its own stock and made payment therefor out of the capital of the bank and the money of the depositors. The laws of the State of Nevada prohibited such transactions. Their acts were illegal, a plain maladministration of the affairs of the bank. There is no room here for quibble over degrees and kinds of negligence for which directors are liable. Illegal acts amount in law to gross negligence and fraud, and the directors are liable for all losses occasioned thereby. Every illegal act is a breach of duty. Neither is there

any ground for quibble over the rights of creditors or stockholders as individuals to sue the officers of a corporation. This action is brought by the Receiver of the bank. Without doubt the bank could have sued its faithless officers for these acts, and any remedy which the bank might have the Receiver has and may enforce as an asset of the bank in his hands. (Zane on Banks and Banking, Sec. 81 and 86; *Coddington* v. *Canaday*, (Ind.) 61 N. E. 567.) Nor will good faith excuse them for losses arising out of their own neglect of duty. They knew that these purchases were being made. They acquiesced in all of them. In many cases they were made under their direction and with their express approval. The courts are asked to go too far when they are asked to exempt from liability for resulting damages one who acts illegally, or to tolerate a conscious breach of positive duty because one claims to so act in good faith. The statute makes no such exception to its prohibition. In *Bank* v. *Lanier*, 11 Wall. 369, 20 L. ed. 172, no doubt the bank officers acted in good faith when in violation of the currency act they accepted the stock of the bank as security for a loan; but the court nevertheless said such act was illegal. Nor does the criterion of reasonable care apply where the officers of a corporation are acting in excess of their power. If they knowingly exceed their authority and thereby inflict a loss upon the corporation, what they did is not open to the test of reasonable care or good faith; but their liability follows as

funds of the bank in *ultra vires* and forbidden enterprises. These propositions are sustained by the following authorities:

1 Michie on Banks & Banking, pages 341, 342;

Cooper v. *Hill*, 36 C. C. A. 402;

Briggs v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;

Trustees v. *Bossieux*, 3 Fed. 817;

Thompson v. *Greeley*, 107 Mo. 577, 591-2;

Marshall v. *Farmers & Mechanics Sav. Bank*, (Va.) 8 S. E. 586, 2 L. R. A. 534;

Oakland Bank v. *Wilcox*, 60 Cal. 126;

Stone v. *Rottman*, 183 Mo. 552, 82 S. W. 76, 83-84;

In re Brocking Mfg. Co., (Me.) 35 Atl. 1012;

Green v. *Hedenberg*, (Ill.) 42 N. E. 851;

Boswell v. *Allen*, 168 N. Y. 157, 55 L. R. A. 751;

U. S. v. *Britton*, 108 U. S. 199, 27 L. ed. 698;

Evans v. *U. S.*, 153 U. S. 584, 38 L. ed. 830;

German Sav. Bank v. *Wulfekuhler*, 19 Kan. 60;

Boyd v. *Schneider*, 65 C. C. A. 209, 131 Fed. 223;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567.

In Michie on Banks & Banking, pages 341-2, it is said:

> "Where a statute prohibits the doing of an act, or imposes a duty for the benefit and protection of individuals, persons who disobey the prohibition or neglect to perform the duty render themselves liable to those for whose protection the statute was enacted for any damage or loss proximately resulting from such disobedience or neglect. Restrictions contained in statutes regulating the business of banking are, generally, of this character, and for violations of the charter or general statutes, directors may render themselves personally responsible to creditors and depositors who sustain loss thereby; as, for example, for waste of corporate funds and property by loaning money without security in cases where security is required to be taken, or investing the money of the bank in speculative enterprises forbidden by law, or accepting securities in payment of subscriptions to the capital stock when it is required by law that such payments shall be in cash, *or who otherwise commit violations of the charter or general law whereby the money or property of the corporation is lost or wasted.* * * * *Where fraud or culpable negligence is shown, the directors can not excuse themselves by pleading mere honesty of intention. Good faith alone will not excuse them where there has been that lack of care, attention, and circumspection in their management of the affairs of the corporation which is exacted of them as quasi-trustees.*"

In *Briggs* v. *Spaulding*, *supra*, it is said:

> "Our attention has not been called, however, to any duty specifically imposed upon the direct-

> ors as individuals by the terms of the act, *although if any director participated in or assented to any violation of the law by the board he would be individually liable.* * * *
>
> " In any view the degree of care to which these defendants were bound is that which ordinarily prudent and diligent men would exercise under similar circumstances, and, in determining that, the *restrictions of the statute* and the usage of business should be taken into account."

In *Trustees* v. *Bossieux, supra*, and in *Stone* v. *Rottman, supra,* illegal acts of directors in paying dividends out of capital, or in permitting illegal overdrafts and investing the funds of a bank in prohibited enterprises, were treated as amounting to gross negligence for which directors were liable. In the case last referred to, the Missouri Supreme Court, approving the conclusions of the referee, said:

> " While the referee finds that the investment of the bank in the coal business and the carrying on of that business was illegal, and as far as those acts were concerned were intentional, yet he does not find that the injury resulting from such acts was intentional and wilful, but simply the result of negligence. In other words, the finding, in effect, is that there was no dishonesty practiced in the transaction with the coal company, but that permitting the overdrafts, in view of the surrounding conditions of the coal company was in fact gross negligence. The referee, in his conclusions, finds that the pleadings were sufficient to support a judgment, and he says that 'the investment of the money in this coal

business was illegal. The money drawn by the coal company took the shape of overdrafts. The pleadings allege that the defendants negligently permitted these overdrafts. The fact that the overdrafts were illegal is consistent with and tends to sustain the allegation that the defendants were negligently permitting them'."

In *Cooper* v. *Hill*, *supra*, a case arising under the National Bank Act, it is said (p. 407):

> " The Statutes of the United States are the measure of the powers of national banks, and these corporations can lawfully exercise none but those there expressly granted, and those fairly incidental thereto. * * * The officers of banks are bound to know and they are charged by the law with the knowledge of the extent and limitations of the powers of the corporations for which they act, and of their own authority as the agents of these corporations. It is said that they are not technically trustees of express trusts, but they are the agents of the bank, charged, under the national banking laws, with an implied trust to use the funds of the bank for the purposes specified in these laws, only, and to preserve them for their creditors and stockholders. *Every agent incurs a personal liability to his principal for losses occasioned by his unauthorized acts under the general law, and the officers of corporations are no exceptions to the rule. Upon this principle the directors and other officers of a national bank become personally liable to the bank and its successor in interest, its receiver, for losses caused by their use of its funds for unauthorized purposes, as well as for culpable negligence in their use and for their fraudulent appropriations.*"

In *Oakland Bank of Savings* v. *Wilcox, supra*, the California court, holding the officers of a bank liable for losses sustained on account of loans made in violation of a provision of its by-laws, said (p. 140):

> "In this case neither the president nor the cashier had any authority to permit an account to be overdrawn. To make an overdraft was a fraud in law on the part of the drawer; to pay or authorize the payment was a fraud in law on the part of the officers paying or authorizing the payment. The money of the stockholders was invested, and of the depositors was deposited, to the end that the business should be managed as the by-laws should prescribe; those by-laws forbid loans to be made without the approbation of the finance committee; and when the president or cashier went beyond that, and loaned upon his or their own judgment, *a violation of duty occurred.*"

In *Thompson* v. *Greeley, supra*, the Supreme Court of Missouri, holding the directors of a bank liable to the Receiver for losses sustained because of illegal loans made, said (pp. 591-2):

> "It is true the statute imposes no penalty or liability on either the corporation or its directors for the violation of its provisions, and an action, therefore, must be at common law for breach of duty. *But every violation of law is a breach of duty.* It has been seen that the directors are responsible to the corporation they undertake to manage for all losses occasioned by any flagrant breach of their duty. Whether that

duty required good faith and honesty in the administration of the affairs of the corporation as is imposed at common law, or whether it was a duty enjoined or an act prohibited by statute, could make no difference as far as the doing or omitting them might affect their liability.

" The liability rests upon the common law rule which 'renders every agent liable who violates his authority to the damage of his principal.' 1 Morawetz on Priv. Corp., Sec. 556. The statute fixed the authority of the directors in respect to the amount in which any person, firm or corporation might become indebted to the bank, and if they wilfully and knowingly permitted the Anchor Milling Company to become indebted to it to a greater amount than was authorized by the statute, and loss to the bank resulted therefrom, they are, and in right should be, liable for such losses. * * * *The wilful violation of the statute and consequent loss therefrom, furnish sufficient proof of liability.*"

While the case last cited was an action at law, nevertheless the court recognized that the same principles would apply where the action was properly cognizable in equity.

It may be contended that the by-laws of the bank (F. 42) impliedly authorized the purchase of its stock by the bank. But it has been held by the Nevada court and other courts that if the by-laws of a corporation are in conflict with the statutes of the state such by-laws are void.

—*State ex rel Corey* v. *Curtis*, 9 Nev. 325;

Herring v. *Ruskin Co-op. Ass'n*, (Tenn.) 52 S. W. 327;

Vercoutre v. *Golden State Land Co.*, (Cal.) 48 Pac. 375;

Cooper v. *Hill*, 36 C. C. A. 402, 407.

In construing the constitution and statutes of another state, the decisions of the Supreme Court of that state are controlling.

—*Fairfield* v. *County of Gallatin*, 100 U. S. 50;

Consumer Gas Trust Co. v. *Quimby*, 137 Fed. 882, 70 C. C. A. 220.

When a person becomes a member of a corporation organized under the laws of another state, he consents to be governed by the general incorporation laws of that state and his rights and liabilities are tested and determined by such laws.

—*Giesen* v. *London etc. Mtg. Co.*, 102 Fed. 584, 42 C. C. A. 515;

Relfe v. *Rundle*, 103 U. S. 222, 226, 26 L. ed. 337;

Railway Co. v. *Gebbard*, 109 U. S. 527;

Silver Mines v. *Brown*, 58 Fed. 644, 7 C. C. A. 412.

It is respectfully submitted that judgment should be entered in this court, on the facts found by the lower court, in favor of appellant and against the appellees, John A. Jesson, James W. Hill and E. R. Peoples, for $12,000 for the purchase of stock from

the Strandbergs and Johnson, and against the appellees, John A. Jesson, Ray Brumbaugh, John A. Clark, J. A. Healey and George Preston, for the purchase of the McGinn stock.

II.

The Purchase of Wood's Stock.

APPELLANT IS ENTITLED TO JUDGMENT AGAINST APPELLEES JOHN A. JESSON, JAMES W. HILL AND R. C. WOOD JOINTLY AND SEVERALLY FOR THE PURCHASE BY THE BANK OF THE STOCK OF SAID WOOD.

The facts are found in detail by the court and without repeating the various Findings thereon, which are copied in full in the forepart of this brief, the court is respectfully referred to Findings Nos. 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 26, 27, 28, 29, 30, 31, 32, 33, 34, 38, 41, 42, 51, 52, 53, 54, 57, *supra.*

The transaction now under consideration differs from those stock purchases heretofore considered in that it was the claim of the appellees in their respective answers that in the organization of such corporation Wood never became either a subscriber to stock or a stockholder therein, and that he consented to the transfer of his share of the partnership assets to the corporation with the understanding that he

should have the option to take either cash or stock therefor and that within the period of such option he elected to take cash, as the result of which election the $13,000 in controversy was paid to him. But the court found these contentions against appellees, and on those findings this matter must be disposed of.

In substance the court found that prior to January 21, 1908, subscriptions for the capital stock of said corporation were circulated and "the name of R. C. Wood was subscribed thereto" by his partner E. T. Barnette (F. 3); that on March 12, 1908, at a meeting of the subscribers to stock held immediately after the receipt of the articles of incorporation, Wood was "declared to be a stockholder of said corporation" (F. 13); that on said March 12, 1908, at a meeting of the Board of Directors it was ordered "that stock issue to said Barnette, Hill and Wood in exchange for the property received from them by said corporation as follows: * * * Wood 220 shares" (F. 14); that on March 16, 1908, a written agreement signed by Barnette and Hill was entered into between the corporation and said partners fixing the value of the resources of the partnership to be transferred to, and the amount of liabilities to be assumed by, the corporation, and fixing the amount of stock to be issued to Wood at 130 shares, "in which said agreement the said Barnette, Hill and Wood agreed to accept stock of the corporation at its par value for the amount of assets in excess of said liabilities" (F. 15); that at the time said written agreement was

signed and during the negotiations leading up to the making of the same Wood was in Seattle "but he was advised fully concerning the same by the defendant Hill by letter and telegram" (F. 19); that prior to the return of Wood to Fairbanks, he "offered to sell his stock in the corporation and to take in payment therefor part cash and a note for the balance, to be secured by said stock as collateral security" (F. 20); that when Wood returned to Fairbanks in April, 1908, "he signed said written agreement so entered into as aforesaid, knowing that the same contained said clause requiring him to take stock for his share of the assets of said partnership so transferred to said corporation in excess of the liabilities thereof" (F. 21); that Wood was elected cashier of the corporation bank on March 12, 1908, and immediately notified thereof (F. 26); that Wood accepted said office of cashier and on March 16, 1908, entered upon the discharge of the duties thereof, and on his return to Fairbanks in April, 1908, entered actively upon such duties and continued so to act until June 29th, 1908, when he tendered his resignation to be effective at the close of business on June 30, 1908 (F. 27), at which time he demanded that there be paid to him $13,000 as the amount of his interest in the partnership assets (F. 38); that a certificate for 130 shares of the capital stock of said corporation bank was written up in the name of defendant Wood of the par value of $13,000 which was never detached from the stock book but was "carried on the books of the bank as outstanding stock from March 16, 1908, to June

30, 1908" (F. 29); that on June 30, 1908, a certificate of deposit "with the approval of the officers and directors of said bank," was issued to and accepted by Wood in the sum of $13,000 "in lieu of said stock," which certificate was signed by the assistant cashier prior to the time said resignation of Wood became effective, "and said shares of capital stock were on the same day charged to treasury stock on the books of said bank" (F. 30); that subsequently Wood "drew out in cash from the funds of said bank" the amount of said certificate of deposit, $13,000 (F. 31).

The court further found generally respecting all the purchases of stock by said bank as follows:

LI.

> " That when stock was so taken back by the corporation, the amount paid therefor was either paid in cash or notes held by the bank were cancelled and surrendered to the stockholders.
>
> " That said bank had no surplus or undivided profits against which the same could be charged."

LII.

> " That the taking back of said stock and the payment therefor as aforesaid was illegal, wrongful, and in violation of the laws of the State of Nevada under which said corporation was organized."

LIV.

> " That said stock surrenders so made as aforesaid were acquiesced in by said directors, and in some instances were made under their directions and with their express approval."

On these Findings of Fact, the court concluded as a matter of law that the appellees Jesson, Hill and Wood were not liable to appellant for the purchase of said $13,000 worth of stock, and dismissed appellant's action therefor (C. of L. 8, R. 199; Decree 9, R. 203). Appellant proposed Conclusion of Law No. 1 allowing him recovery against said appellees for said item (R. 204-5), which was denied. Appellant excepted to the denial of said proposed Conclusion of Law No. 1 (R. 218, Ex. 3) and particularly excepted to the denial of that portion of the same which related to said item (R. 220, Ex. 8). Appellant also excepted to said dismissal (R. 220, 221; Ex. 12, 13, 14). The above matters are assigned as error in Assignments of Error Nos. 3, 8, 12, 14, 21 (R. 229-234).

From the foregoing facts found by the court there is no escape from the conclusion that Wood subscribed for the capital stock of said corporation bank; that he was accepted as such stockholder by the other subscribers; that he was recognized by the directors as such stockholder; that he acknowledged himself to be such stockholder by his acts and conduct; that stock was issued to him and carried on the books of the bank, during all the time he was cashier, as outstanding stock; and that with the approval of the officers and directors of said bank and at a time when the bank had neither surplus nor undivided profits said stock was wrongfully and illegally purchased by the bank, which amounted to a division of the capital of the bank among the stockholders or else a payment

therefor out of the money of its depositors. At the time said stock was purchased and paid for, the defendant Jesson was a member of the board of directors, and the defendant Wood was its cashier and a member of its executive committee (F. 34). The executive committee had the same powers as the board of directors subject to approval by said board (F. 18).

In this transaction, there is no claim that Wood's stock was purchased in satisfaction of a pre-existing indebtedness or to be relieved of an annoying and dissatisfied stockholder. None of the exceptions to the rule forbidding a corporation to purchase its own stock have any application here. It falls clearly within the general prohibition of the law.

At the trial below, it was urged that recovery could not be had on account of this transaction because it grew out of those matters connected with the taking over by the corporation of the affairs of the former partnership, which contract had been fully executed and could not in this action be now rescinded. The fallacy of that contention is two-fold: *First*, the taking back of Wood's stock does not arise out of such contract. He elected, as found by the court, to take this stock for his alleged share of the partnership assets, and became a stockholder in the corporation. That completed the transaction involved in said contract. Everything happening afterwards was a new deal for the taking back of said stock. *Second*, this is not an action for rescission of such

contract, but one for damages against the officers or agents of the bank for their misconduct and maladministration of the affairs of the bank. It is not an action brought by one of the parties to the contract against the other parties thereto; but is an action by the bank against the officers and agents for what they did in such capacity. True, Wood and Hill were also parties to said contract; but they are sued herein as officers and agents of the bank and not as strangers to it. (Complaint, Pars. XIX, XXXVIII, R. 21-24-42.) If the principle of rescission of executed contracts were to be applied to this action, then it would follow of necessity that a principal could never maintain an action against his agent for misconduct or breach of trust. His only remedy would be to discover and intercept the act before its completion. The bank would be remediless even in cases of embezzlement by its officers.

The same authorities heretofore discussed when considering the purchase of the McGinn and Strandberg stock are applicable to the purchase of Wood's stock, and to them reference is now respectfully made. Under these decisions the officers and directors now before the court, namely, Hill, Jesson and Wood, who participated in such purchase, are unquestionably liable.

In addition to the reason supported by the foregoing authorities for holding appellees liable for this transaction the attention of the court is invited to the fact that this transaction in itself amounted to a

fraud. Included in the assets transferred by said partnership to the corporation bank and accepted by it at their face value were certain notes then past due and still remaining in the hands of the Receiver "unpaid and uncollectible," amounting to $69,908.94 (F. 22). It appears (F. 14 and 15) that, by the terms of the written contract between the partnership and the corporation bank, the assets of said partnership so transferred to and accepted by it were valued at $790,940.31 and the agreed liabilities of the partnership were $538,940.31. This left an apparent excess of assets over liabilities of $252,000 which belonged to the three partners, of which amount the partners agreed to take $52,000 in stock of the corporation, one-fourth of which belonged to Wood. The remaining $200,000 belonged to Barnette as capital invested in the partnership. The amount coming to Wood under this arrangement was $13,000, for which the stock in question was issued to him. It will thus be seen that Wood's stock was issued in consideration of property transferred by the partnership to the corporation, included in which was said $69,908.94 of worthless notes, which would completely wipe out the consideration for said $52,000 worth of stock. Each of these appellees had full knowledge that said notes were past due at the time of said transfer (F. 57). Included in said past due paper were two notes of the Tanana Electric Company aggregating $27,-997.38 which at the time of said transfer were known to be utterly worthless (F. 23 and 24), and also included in said past due paper was paper of the face

value of $22,979.99 which, prior to said transfer, had been charged *on the books of said partnership* to a doubtful account, of which notes so charged to said doubtful account $12,860.61 "remains unpaid and uncollectible" (F. 35). These last two items of loss, arising out of the transfer and acceptance of said past due paper, alone amount to $40,857.99 excluding interest, one-fourth of which, or $10,214.50, unquestionably should have been deducted from the credit of $13,000 allowed in payment of Wood's stock.

In addition to this worthless paper there was transferred shares of the capital stock of the Gold Bar Lumber Company at a valuation of $341,949.00, which was clearly an overvaluation thereof (F. 25, 40); and the partners were subsequently allowed and paid $39,642.81 as accrued interest on the loans and discounts so transferred. This last matter is considered in another portion of this brief.

The court found that these appellees, Hill, Wood and Jesson, were officers and directors of the corporation bank at the time the written agreement for the issuance of said stock in exchange for said partnership assets and the acceptance of said past due notes at their face value, was entered into, confirmed and approved, and that said Hill and Wood were members of said partnership and "personally interested therein adversely to said corporation" and that they "acquiesced in said transaction and gave their consent thereto with full knowledge on the part of each of them of the facts heretofore found respecting said

transactions" (F. 57). To accept and pay for these Tanana Electric Company notes at their face value, knowing that they were worthless was a gross violation of duty on the part of these officers; exercise of the slightest care on their part would have saved the bank from any loss arising out of the paper which was then carried on the books of the partners as doubtful; exercise of ordinary care would have prevented them from accepting at full face value the entire amount of this worthless past due paper. These matters are considered in a subsequent subdivision of this brief. Only a fraudulent and wilful disregard of duty could have induced them, on June 30, 1908, three months after they had taken over these assets and had occasion to observe from actual experience their uncollectibility, to pay to Wood $13,000 in cash for his stock purchased with them. They knew, or by the application of the slightest intelligence and diligence could have known that the bank had been defrauded by this former transaction; and, knowing that, they deliberately turned over the fruits of the fraud, to the extent of $13,000, to a defrauding party. It would have become them with much better grace to have then stood on the completed and executed contract.

It may be well to call the court's attention at this time particularly to the fact that these appellees, Hill and Wood, who participated in the foregoing transaction as officers of the corporation, are the same Hill and Wood who were members of said partnership.

whose assets were transferred to and accepted by the corporation in payment of said stock. As members of the partnership they had full knowledge of the entire transaction, and, as officers of the corporation they, together with the appellee Jesson, who also had full knowledge of the facts in said transaction, acquiesced in the same and gave their consent thereto (F. 57). In the purchase of this stock by the bank, Wood had a direct personal interest which he safeguarded to the neglect of his duty as an official of said bank. More specific attention will be given to this point hereafter in considering the liability of the officers and directors for transactions arising out of the purchase of the partnership assets.

III.

The Purchase of Worthless Notes.

APPELLANT IS ENTITLED TO JUDGMENT AGAINST APPELLEES JOHN A. JESSON, JAMES W. HILL AND R. C. WOOD JOINTLY AND SEVERALLY FOR THE PURCHASE FROM THE PARTNERSHIP OF $69,908.94 OF PAST DUE AND WORTHLESS NOTES; PARTICULARLY THE TANANA ELECTRIC COMPANY NOTES AGGREGATING $27,997.38, AND NOTES AGGREGATING $12,860.61 WHICH THE PARTNERSHIP WAS CARRYING IN AN ACCOUNT KNOWN AS "DOUBTFUL ACCOUNT" AT THE TIME OF SAID PURCHASE.

The facts bearing upon this transaction are found in Findings 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14,

15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 35, 36, 38, 39, 40 and 57, *supra*.

This transaction arises out of the taking over of the affairs of the partnership by the corporation bank. According to the terms of the written agreement entered into between said partnership and said corporation, the corporation bank assumed the liabilities of the partnership, including an obligation of $252,000 to the partners individually, in consideration of the transfer to it of the partnership assets. As a part of these assets were certain specified loans and discounts, and included in this item were $69,-908.94 of paper then past due which the corporation accepted at face value, and which the court found is still in the hands of the Receiver "unpaid and uncollectible" (F. 22). The above named Hill and Wood, appellees herein, together with one Barnette composed said partnership, and, upon the organization of the corporation bank, Barnette became its president, Hill its vice-president and member of its executive committee, and Wood its cashier, and they were such officers of the corporation when said written agreement was entered into. The appellee Jesson was at said time a member of the board of directors of the corporation.

Included in said past due paper were two notes of the Tanana Electric Company, as to which the court made the following findings of fact:

XXIII.

" That of said notes so past due as aforesaid,

there were two executed by the Tanana Electric Company in the sum of $27,997.38 which depended for their value upon the existence of an alleged guaranty of the Scandinavian-American Bank to make advancements sufficient to cover the same; that said alleged guaranty never had any existence in fact, and the claim therefor had been repudiated by said Scandinavian-American Bank prior to the time said note was accepted by said board of directors, *and said repudiation was known to the members of said board.* That said notes are still unpaid, and the same was at all times carried on the books of the said Washington-Alaska Bank, formerly Fairbanks Banking Company, as an asset in the sum of $27,997.38."

XXIV.

" That said board of directors and the officers of said bank accepted said notes of the Tanana Electric Company and paid therefor the sum of $27,997.38, *with knowledge on the part of each of them that the same depended for their value upon said alleged guarantee alone.*"

In the matter of the "doubtful account" notes which were included in said past due paper, the court found:

XXXV.

" That of the notes accepted from said partnership as aforesaid and paid for by said corporation, there were charged on December 31, 1907, by said partnership on the books of said partnership to an account known as 'doubtful account' the sum of $22,979.99 and said doubtful a c c o u n t, so including said notes in said amount, was then depreciated on the said books

to the amount of thirty-three and one-third per cent thereof, which said notes were accepted by said corporation and paid for by them in the amount aforesaid, to-wit, $22,979.99, all of which said notes were then past due, and of which there still remains unpaid and uncollectible the sum of $12,860.61. That of said notes so charged to said doubtful account as aforesaid, there was on December 31, 1909, charged by said corporation to the account of profit and loss on the books of said corporation the sum of $12,-192.80."

LVII.

" * * * That at the time the aforesaid resolution was adopted by the said board of directors to take over the business and affairs of said partnership; * * * and at the time said past due notes held by said partners were accepted and paid for by said corporation, including said notes of the said Tanana Electric Company and said notes which had been charged to the doubtful account of said partnership as aforesaid; * * * the following defendants now before the court in this action were officers and directors of said corporation and acquiesced in said transactions and gave their consent thereto with full knowledge on the part of each of them of the existence of the facts heretofore found respecting said transactions, to-wit, James W. Hill, vice-president and member of its executive committee, John A. Jesson, member of its board of directors, R. C. Wood, its cashier. That the said Hill and Wood were also members of the partnership with which said corporation contracted respecting said matters *and were each personally interested therein adversely to said corporation.*"

On these Findings the court concluded as a matter of law that the appellees Jesson, Hill and Wood were not liable to appellant for the purchase of said notes, and dismissed appellant's action therefor (C. of L. 8, R. 199; Decree 9, R. 203). Appellant proposed Conclusion of Law No. 1 allowing him to recover against said appellees for said transaction (R. 204), which was denied. Appellant excepted to the denial of said proposed Conclusion of Law No. 1 (Ex. 3, R. 218) and particularly excepted to the denial of that portion of the same which related to said transaction (Ex. 5, 6, R. 219). Appellant also excepted to said dismissal (Ex. 12, 13, 14; R. 220, 221). The above matters are assigned as error in Assignments of Error Nos. 3, 4, 5, 12, 14, 17, 18 (R. 229, 231-233).

The exercise by the directors and officers of the slightest degree of diligence would have saved loss on this transaction so far as the notes of the Tanana Electric Company and the notes charged to "doubtful account" on the books of the partnership prior to the transfer to the corporation, are concerned. These items aggregate $40,857.99. Appellees, Hill, Wood and Jesson acquiesced in the transaction with full knowledge of the facts, and Hill and Wood were personally interested therein adversely to the corporation whose interests it was their duty as officers to protect. There is really no room for the application of any rule of diligence to this transaction. Diligence is only important in determining whether or not the officers knew or could have known of any infirmity

in the paper. If they knew of such infirmity, and the court has found that they did so know, then there is no question of loss through failure to use due care to avoid it. This was wilful and fraudulent misconduct on their part, if not downright criminality. One can not purchase property known to him to be worthless, and then be heard to say that he carefully guarded against loss. Particularly is this true as to Hill and Wood who had a personal interest in the matter.

It was contended on the trial below that there could be no recovery on this transaction, nor for the payment to said partners of accrued interest on said loans and discounts next considered in this brief, for the reason that each was a part of the contract for the taking over by the corporation of the partnership assets, which contract had been fully executed and could not be rescinded under the pleadings herein, if it could be at all. But again, appellant states that this is not an action for rescission of contract. It is an action to recover against faithless officers and agents of the bank such damages as the bank sustained on account of their actions. It is not a suit by one of the parties to the contract against the other party. If it were so, it would not have been proper or necessary to join as defendants all the officers and directors of the bank participating therein, but only those individuals who were members of the partnership. That this is not a suit for rescission of contract clearly appears from the complaint, especially Pars. IX and XXXVIII (R. 12-14, 42). It was also contended at the trial that the purchase of these notes

was authorized by the proposed incorporators. But, "As against the claims of creditors of an insolvent corporation, the directors cannot shield themselves from liability for gross mismanagement of its affairs by interposing a pretended authorization by the stockholder." (*Coddington* v. *Canaday*, (Ind.) 61 N. E. 567, 571.)

The law bearing generally upon the liability of officers and directors for misconduct such as that found by the court in the purchase of these worthless notes has been reflected in the cases heretofore cited and commented upon in this brief. The attention of the court, however, is respectfully invited to the following authorities dealing with transactions of the kind now particularly under consideration, namely:

Michie on Banks & Banking, pp. 267, 296-297, 367;

Briggs v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;

Marshall v. *F. & M. Sav. Bank*, (Va.) 8 S. E. 586, 2 L. R. A. 534;

Ryan v. *Ry. Co.*, 21 Kan. 365;

F. & M. Bank v. *Downey*, 53 Cal. 466;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567;

Trustees v. *Bossieux*, 3 Fed. 817;

Bosworth v. *Allen*, (N. Y.) 61 N. E. 163;

Stearns v. *Lawrence*, 28 C. C. A. 66;

Koehler v. *Hubby*, 67 U. S. 717, 17 L. ed. 339;

Wilbur v. *Lynde*, 49 Cal. 290;

Kankakee Woolen Mills Co. v. *Kampe*, 38 Mo. App. 229;

Wardell v. *Railroad Co.*, 103 U. S. 651, 26 L. ed. 509;

Bundy v. *Jackson*, 24 Fed. 628.

"The directors of a corporation are its primary agents, and, in reference to corporate property act in the relation of trustees. The character of their relation requires of them the highest and most scrupulous good faith in their transactions for the corporation and the stockholders. The law does not permit them to manage the affairs of the corporation for their personal and private advantage, nor pecuniarily to be interested in contracts which other parties make with the corporation, through their influence and direction."

—*Ryan* v. *Railway Co.*, 21 Kan. 365 (1st Syl.).

In Michie on Banks & Banking, pages 296-297, it is said:

"Wherever in dealings between an officer or agent and his bank the element of the personal interest of such officer or agent enters, so that he occupies, as regards such personal interest, a position adverse to that of the bank, a situation has arisen calling for the exercise of that degree of fairness and good faith known as *uberriemae fidei*. In every such transaction his conduct will be examined with the closest scrutiny, and it is his duty to not only make full disclosures of all material facts within his knowledge, but if, in such transaction, he represents both the bank and his own interests, then it is plainly his duty,

as an officer of the bank, to execute his trust with an eye single to the interests of the bank, and, in case of conflict, to guard the interest of the bank even to the loss or destruction of his own. * * * The directors of a corporation hold a fiduciary relation to the stockholders, and have been intrusted by them with the management of the corporate property for the common benefit and advantage of each and every stockholder, and by their acceptance of this office they preclude themselves from doing any act, or engaging in any transaction, in which their private interest will conflict with the duty they owe to the stockholders, and from making any use of their power or of the corporate property for their own advantage. *It is against public policy to permit persons occupying fiduciary relations to be placed in such a position that the influence of selfish motives may be a temptation so great as to overpower their duty and lead to a betrayal of their trust, and the rule is unyielding that a trustee shall not, under any circumstances, be allowed to have any dealings in the trust property with himself, or acquire any interest therein. Courts will not permit any investigation into the fairness or unfairness of the transaction, or allow the trustee to show that the dealing was for the best interest of the beneficiary, but will set the transaction aside at the mere option of the cestui que trust. There is no limit to the variety of the circumstances under which cases illustrating these principles may arise."*

Even the rule that directors and officers are bound to use that degree of care which ordinarily prudent and diligent men would exercise under similar circumstances ought to render them liable for ac-

cepting and paying for this entire lot of worthless past due paper aggregating $69,908.94.

> "If they became acquainted with any fact calculated to put prudent men on their guard, a degree of care commensurate with the evil to be avoided is required, and a want of care certainly makes them liable."
>
> —*Briggs* v. *Spaulding, supra.*

Stearns v. *Lawrence, supra*, is a case very similar to this one as respects the taking of the Tanana Electric Company notes. Stearns was president of a bank and one Baker was its cashier. The bank held certain paper on which Baker was either endorser or the maker thereof. This paper, Stearns exchanged for a note owned by Baker and executed by Anderson & Griffen. This Anderson & Griffen note depended for its worth upon the extent of a certain guaranty respecting the quantity of timber the lands in purchase of which it was executed would produce. The amount of the note was to be reduced at the rate of $3.50 for each thousand feet of lumber short of the guaranteed number of feet. Stearns purchased the note for the bank with full knowledge of such guaranty. The quantity of lumber on the land sold turned out to be below the number of feet guaranteed, and Anderson & Griffen enforced a credit against the bank for the deficiency. Afterwards the bank failed, and Lawrence as its receiver brought suit against Stearns for damages for alleged breach of trust and

negligence. Decree was entered in favor of the receiver. It was held (Syl. 3):

> "The purchase of a note by the president and managing officer of a bank, for which he paid from its funds over $20,000, with knowledge that it was burdened with a guaranty made by the payee, which might defeat its collection, *is such negligence as renders him liable to account to the bank or its creditors for any loss which resulted.*"

In *Bosworth* v. *Allen*, *supra*, the New York Court of Appeals said:

> "Equitable jurisdiction extends to all culpable acts and omissions of the directors by which the pecuniary interests of the corporation are or may be injured. If they are treacherous to its interests and appropriate its property or intentionally waste its assets, or take money for official action, or 'sell out' by resigning, and thus give control to others, they are liable to account in equity to the corporation or its representatives, not only for the money or property in their hands, but also for such as they fraudulently disposed of or wasted, as well as for the damages naturally resulting from their official misconduct and even as we have recently held, for money received by virtue of their office."

Coddington v. *Canaday*, *supra*, is a very similar case to the one at bar. In that case a bank, known as the Citizens Bank, on the expiration of its charter, reorganized, taking over the affairs of the old bank. The defendants were directors in the old bank and,

upon such reorganization, became directors of the new bank. The new bank afterwards became insolvent and the Receiver brought suit against the directors for damages arising out of their negligence and inattention in the management of its affairs. The complaint among other things charged that in taking over the old bank, said directors took over for the new bank real estate at an excessive valuation and some worthless notes, drafts, checks, etc., at their face value in payment of stock subscriptions and carried them on the books of the new bank at such face value. As a partial defense to this charge of the complaint, it was set up that the new bank with the consent of its stockholders and acting upon reliable legal advice accepted the real estate, notes, judgments, etc., in payment of stock subscriptions and that, in the transfer of this property to it, agreed that it should be applied in discharge of all legal claims against the old bank; that the new bank accepted said property and proceeded to use, collect, sell and convert it to its own use. The agreement with the stockholders was in writing. In affirming the action of the lower court sustaining a demurrer to this defense the court said:

> " Corporations, other than banking, may, perhaps, take property of certain kinds at reasonable valuation, and under circumstances entirely free from fraud, in payment of such subscriptions; but banks stand upon a different footing, and the reasons which justify such dealings in the one case do not apply in the other. But, even if notes, bills, judgments, and the like, could

be taken by the directors in payment of stock subscriptions, they could not lawfully be so taken unless there was reasonable ground for believing that they were good and collectible, and of the value at which they were to be received. If they were worthless, as charged in the complaint, it was the duty of the directors of the new bank to refuse to recognize them as payment for such stock subscriptions, and a failure to exercise ordinary care in accepting them in lieu of money was a breach of their duty as the agents of the corporation. Such a transaction was a deviation from the usual course of business, and it devolved on the appellants to show that the notes, bills, judgments, etc., so taken and recognized by them were of the value at which they were transferred or that they exercised ordinary care in ascertaining their value, and had reason to believe them to be worth the amounts for which they were taken. An agent authorized to sell the property of the principal, or to collect debts due to him, is guilty of a gross breach of his duty, if, instead of obtaining money, he carelessly receives worthless paper or securities.

" But the appellants insist that the acceptance of the notes, bills, judgments, and real estate by the directors of the new bank in payment of stock subscriptions was expressly authorized by the stockholders, and therefore the receiver, who represents the stockholders, is estopped from asserting any claim against the directors on this account. If the stockholders alone are interested, the argument of the appellants on this question might deserve serious consideration. The complaint alleges that the corporation is insolvent. The receiver therefore represents the interests of the creditors of the bank, as well as those of the stockholders. *As against the*

claims of creditors of an insolvent corporation, the directors cannot shield themselves from liability for gross mismanagement of its affairs by interposing a pretended authorization for their wrongdoing by the stockholders."

By the use of worthless notes as an asset of the partnership, Hill, Barnette and Wood were enabled to pay for their $52,000 worth of stock in the corporation, and Wood was enabled to convert his portion thereof, $13,000, into cash by the hereinbefore considered sale of his stock. In Michie on Banks and Banking, page 367, it is said:

" Where the directors of a bank take notes, judgments, and the like in payment of subscriptions to stock, it is incumbent on them to show that such notes, etc., were of the value for which they were transferred, or that they exercised ordinary care in ascertaining their value, and had reason to believe them to be worth the amounts for which they were taken, in order to escape liability therefor, as such transactions are a deviation from the usual course of business. For accepting such unauthorized securities in payment for stock the directors may, in case of loss, be held personally liable for the full amount of the stock so paid."

It is respectfully submitted that appellant is entitled to judgment against the said Hill, Wood and Jesson for $69,908.94 on this transaction.

IV.

The Payment of Accrued Interest to Partnership.

Appellant Is Entitled to Judgment Against Appellees John A. Jesson, James W. Hill and R. C. Wood for $39,642.81 Paid to Said Partnership as Accrued Interest on Notes Purchased From It by Said Corporation.

This matter is covered by Findings 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 35, 36, 37, 38, 39, 40 and 57 hereinbefore set out in full.

This transaction also arises partly out of the taking over of the business of the partnership by the corporation bank. Pursuant to the written agreement entered into for the accomplishment of this purpose, there was transferred to the corporation loans and discounts aggregating $353,842.54. This agreement, as found by the court (F. 15), is annexed as "Exhibit One" to the complaint and is found at pages 44 to 66 of the record. A reference to it will show that said item of loans and discounts is made up of a great number of notes, listed separately both by number and name of borrower and after each note is placed the amount thereof, a schedule of which is attached to the contract (R. 46, 56-62). In said agreement the partners are designated as "parties of the first part" and the corporation as "party of the sec-

ond part" (R. 44-45), and it is therein provided (R. 51):

> " The parties of the first part hereby assign, transfer and set over unto the party of the second part all of their outstanding loans and discounts as the same appear in the scheduled statement hereto attached marked 'Exhibit A,' and the notes of the debtors given to evidence the amount of such loans and discounts, together with all mortgages upon real or personal property that have been given to secure the same, and hereby agree that they will transfer to the party of the second part by proper endorsement all of said notes and mortgages and forthwith deliver the same unto the possession of the party of the second part.
>
> " * * * The intention of this agreement being to place the party of the second part in the shoes of the parties of the first part as to the banking business of the Fairbanks Banking Company as to all properties heretofore mentioned and specified."

Leading up to the execution of this written agreement it appears from the Findings that said partnership (which was also known by the name of Fairbanks Banking Company), owing to financial difficulties, had been compelled in December, 1907, to suspend business and close its doors, passing into the hands of trustees (F. 4). In the forepart of January, 1908, certain proposed incorporators held a meeting for the purpose of organizing a corporation to purchase, take over and absorb the business of said partnership. At said meeting negotiations for such

purchase were begun and a committee was appointed to go into the details of the reorganization and report a basis upon which the business should be taken over (F. 7). This committee met on January 5, 1908, and reported a scheme for accomplishing such purpose which, among other things provided the acceptance of the partnership property on a basis of $288,000 in excess of its liabilities, and that all interest on existing loans as of December 19, 1907, be computed to *February* 15, 1908, and the amount of such accrued interest be placed to the credit of the old institution on the books of the new corporation, the same to be payable on or before December 31, 1908 (F. 8). This report was submitted to a meeting of the proposed incorporators on January 6, 1908, and adopted, and at the same meeting subscriptions to the capital stock were taken, and it was also agreed on behalf of the partnership that it would turn its property over to the corporation on the terms specified in said report (F. 9, 10, 11). The Fairbanks Banking Company, a corporation, became such on January 21, 1908, and on February 8, 1908, a meeting of the subscribers to the capital stock was held for the purpose of executing their stock subscription notes, and the election of a board of directors to serve until the articles of incorporation arrived from Nevada (F. 12). Some time in March, 1908, said articles of incorporation arrived, and immediately thereafter a meeting of the stockholders was held which elected a board of directors and adopted bylaws and "passed a resolution to the effect that the

matter of taking over the property of the Fairbanks Banking Company, a partnership, *be left to the board of directors.*" (F. 13.) Thereafter on March 12, 1908, the board of directors held a meeting and adopted the resolution of the proposed stockholders referred to in Finding 8, "except that the resolution providing for the payment of accrued interest up to *February* 15, 1908, was by them amended so as to read '*March* 15, 1908' " (F. 14). On March 16, 1908, the written agreement referred to was entered into in which the value of the assets of the partnership in excess of its liabilities was reduced from $288,000 to $252,000 (F. 15) *and no provision whatever was made for the payment of said accrued interest.* The matter of preparing the paper for the transfer of said property was, by the directors, left to the executive committee, who examined into the affairs of said partnership, and afterwards prepared and submitted to the board of directors said written agreement and the same was approved by them (F. 17). It was signed on March 16, 1908, by said Barnette and Hill, two members of the partnership, and by the corporation through its president and secretary (F. 15). Later on, in April, 1908, Wood, the remaining partner signed it, "knowing that the same did not provide for the payment of said accrued interest" (F. 21). On March 23, 1908, pursuant to the resolution of the board of directors adopted on March 12, 1908, said accrued interest was computed to March 15, 1908, in the sum of $39,652.81, which was placed to the credit of said partners and subsequently paid

to them in cash (F. 36). At the time said accrued interest was computed and allowed to said partners and placed to their credit as aforesaid, the appellee Hill was vice-president of said corporation and member of its executive committee; Wood was its cashier; and Jesson a member of its board of directors. Each acquiesced in the transaction and gave consent thereto with full knowledge of the existence of the above facts found by the court, and Hill and Wood as members of the partnership were personally interested therein adversely to the corporation (F. 57).

On the facts as thus found, the court concluded as a matter of law that the appellees Jesson, Hill and Wood were not liable to appellant for the allowance of said accrued interest and dismissed appellant's action therefor (C. of L. 8, R. 199; Decree 9, R. 203). Appellant proposed Conclusion of Law No. 1 allowing him to recover against said appellees for said item (R. 204), which was denied. Appellant excepted to the denial of said proposed Conclusion of Law No. 1 (R. 218, Ex. 3) and particularly excepted to the denial of that portion of the same which related to said item (Exs. 6, 7, R. 219.) Appellant also excepted to said dismissal (Exs. 12, 13, 14; R. 220, 221). The above matters are assigned as error in Assignments of Error Nos. 3, 6, 7, 12, 14, 19, 20 (R. 229, 230, 231, 232, 233).

The payment to said partners of this accrued interest item was a clear gift to them of the assets of the bank. The so-called excess of partnership assets

over liabilities aggregating $52,000 was more than exhausted by the purchase of $69,908.94 of worthless past due paper, heretofore commented on. To add to that a gift of $39,642.81 would make extreme generosity to himself the criterion of duty on the part of an officer of a bank. It would have required 76 per cent of this so-called excess to wipe out the Tanana Electric notes alone, paper known to be utterly worthless and for which full value was paid. But the directors even included in said item interest on the Tanana Electric Company's notes, as well as all other past due and worthless paper (F. 22). These officers and directors also generously paid to said partners $341,949 for the capital stock of the Gold Bar Lumber Company which never yielded a dollar profit to the partners or the corporation (F. 40), and which was then tied up in litigation (Written Agreement, R. 40). In arriving at this valuation on said Gold Bar Lumber Company stock it was agreed in said written agreement that the value of its timber lands should be increased one-third, or $68,318.68, just prior to the purchase (R. 64). Having previously given said partners $138,227.62 for worthless notes and increased valuation of this lumber company stock, was it not time for these officers to begin exercising some degree of care in protecting the interests of those who were not interested adversely to said corporation?

But it was contended at the trial that the payment of this accrued interest item was made with the

approval of the incorporators. The answer is found in *Coddington* v. *Canaday*, (Ind.) 61 N. E. 567, 571:

> "As against the claims of creditors of an insolvent corporation, the directors can not shield themselves from liability for gross mismanagement of its affairs by interposing a pretended authorization by the stockholders."

But this transaction, even if tentatively authorized by the proposed incorporators, was not included in the written agreement thereafter entered into wherein the full details on which the transfer was to be made were reduced to writing and signed by both the corporation and the partnership. While the proposed incorporators in their proposal for reorganization did provide as set out in Finding 7 for computing interest on existing loans to *February* 15, 1908, they also proposed the acceptance of the notes, properties and securities of the partnership at a valuation of $288,000 in excess of its liabilities (F. 8). This was nothing but a proposed basis for reorganization. But after the incorporation was completed and when the stockholders came to act upon the matter, they left "the matter of taking over the property" of the partnership to the board of directors (F. 13). When the board came to act, it adopted and approved the resolutions of the proposed stockholders except they provided for payment of accrued interest to *March* 15, 1908 (F. 14), instead of *February* 15, as proposed by the incorporators. Thus it will be seen that the directors did not act in pursuance to said res-

olution. The board of directors then left the matter of preparing the papers for the transfer to the executive committee, under whose direction the above mentioned written agreement was prepared and afterwards submitted to and approved by the board (F. 17). This committee "examined the affairs of said partnership" (F. 17). We don't know how thorough that examination was or what it disclosed further than that after such examination the written agreement was prepared and it omitted all reference to allowance of accrued interest, and reduced the excess of purported assets over liabilities from $288.000 to $252,000 (F. 15).

The terms of the written agreement are plain. "The parties of the first part do hereby assign, transfer and set over unto the party of the second part *all of their outstanding loans and discounts as the same appear in the scheduled statement hereto attached and the notes of the debtors given to evidence the amount of such loans and discounts.* * * * The intention of this agreement being to place the party of the second part *in the shoes* of the parties of the first part * * * as to all properties hereinbefore mentioned and specified" (R. 51-2). In said schedule, each loan is listed separately followed by the amount thereof, and the total aggregates $353,842.54 (R. 56-62). The sale of the notes carried with them the interest accrued and accruing. This became the final agreement between the parties, and pursuant to it the transfer was made. The directors had no power to

change the terms of this plain agreement and place to the credit of partners said sum of $39,642.81. It was a gift to them pure and simple. It not only was an act in violation of the written agreement but it violated the proposal of the intended incorporators as well. It was a wilful, wrongful diversion of the assets of the corporation for which they are liable. The matter is covered generally by the principle of the authorities heretofore cited. The following are specifically referred to:

> *Briggs* v. *Spaulding*, 141 U. S. 132, 35 L. ed. 662;
> *Coddington* v. *Canaday*, (Ind.) 61 N. E. 567;
> *Bosworth* v. *Allen*, (N. Y.) 61 N. E. 163;
> *Wardell* v. *Railroad Co.*, 103 U. S. 651, 26 L. ed. 509;
> *Ryan* v. *Railway Co.*, 21 Kan. 365;
> *Cooper* v. *Hill*, 36 C. C. A. 402, 407;
> Michie on Banks & Banking, pp. 296-297.

It will be noted by the court that of said accrued interest so paid by the bank to said partners, approximately $7500 was never collected by the bank from the borrowers (F. 37). To this extent, such payment resulted not alone in loss of earnings but a depletion of the very corpus of the bank itself. In so far as the bank collected such interest from the borrower, it reimbursed itself for the gift; but still it sustained a direct loss of earnings by this transaction. Having bought the paper, it was entitled to the earnings on

its money invested therein. These appellees had no right to give them away to a favored few, nor distribute them among the stockholders in any manner, except as dividends lawfully declared and fairly paid.

Appellant has asked that he be granted recovery from appellees Jesson, Hill and Wood for the entire $39,642.81 dividing the same into two items, namely: accrued interest on partnership notes paid to Barnette, Hill and Wood and which was not collected, $7500, and balance of accrued interest paid to Barnette, Hill and Wood on partnership notes purchased, $32,142.81 (Bill of Exceptions 3, 6 and 7, R. 219; Assignments of Error 3, 6, 7, 19 and 20, R. 229-230, 233).

V.

Interest on Money Invested in First National Bank Stock.

APPELLANT IS ENTITLED TO JUDGMENT AGAINST APPELLEES JOHN A. JESSON, R. C. WOOD, JOHN L. MCGINN AND RAY BRUMBAUGH JOINTLY AND SEVERALLY FOR ONE YEAR'S INTEREST UPON THE AMOUNT OF THE FUNDS OF SAID BANK WHICH WERE INVESTED IN THE CAPITAL STOCK OF THE FIRST NATIONAL BANK.

Appellant requested the court to make a conclusion of law as to this item, being appellant's proposed Conclusion of Law No. 11, and the same is found in the Bill of Exceptions at page 206 of the record, which

was denied and appellant's action therefor dismissed (C. of L. 8, R. 199; Decree 9, R. 203). To the denial of this proposed conclusion of law, appellant duly excepted (B. E. 11, R. 220) as well as to said dismissal (Exs. 11, 12, 14; R. 220, 221), and the same was assigned as error in Assignments 11, 12, 13 (R. 231, 232). The facts upon which this error is based are set out in Findings 55 and 59 (R. 193-4, 196), the substance of which is as follows:

That in May, 1909, the Fairbanks Banking Company and the Washington-Alaska Bank of Washington each purchased one-half of the capital stock of the First National Bank for which each paid the sum of $62,500.00 or $125,000.00 in all, and continued to own and hold said stock until May 4, 1910, on which date the Fairbanks Banking Company sold said entire capital stock to appellees Wood and McGinn for $125,000 and received said amount in payment therefor delivering to them said capital stock of said First National Bank; that at the time said banks purchased said stock, they gave to said Wood an option to purchase the same on or before June 1, 1910, for the said sum of $125,000, and said sale to Wood and McGinn was made in pursuance to said option; that neither of said banks ever received any dividend on said stock during the time the same was owned and held by them, and neither of them ever received any interest from Wood and McGinn, or anyone in their behalf on the money they had invested in said stock during the time the same was invested; that at

the time of said sale to McGinn and Wood the appellees Jesson, Wood, McGinn and Brumbaugh were officers and directors of said Fairbanks Banking Company and each consented to said sale on the terms above stated (F. 55, 59).

In order that the court may not become confused in the names of these banks, it may be stated that at the time of this transaction there were three corporations doing a banking business at Fairbanks, Alaska, namely, Fairbanks Banking Company, organized under the laws of *Nevada*, Washington-Alaska Bank of *Washington* and First National Bank. Said corporation Fairbanks Banking Company was the successor of the partnership of Barnette, Hill and Wood, doing business under the partnership name of Fairbanks Banking Company. On September 14, 1909, the Fairbanks Banking Company, a corporation, bought the entire capital stock of said Washington-Alaska Bank of Washington and subsequently, on October 1, 1910, the Fairbanks Banking Company took over the assets of the Washington-Alaska Bank of Washington, assumed and agreed to pay its outstanding liabilities, and thereupon the last named bank ceased to exist or do business as a bank. Thereupon the Fairbanks Banking Company, by amendment to its articles of incorporation, changed its name to Washington-Alaska Bank of *Nevada*, under which name we deal with it in the Receivership herein (F. 56, 64).

From the foregoing it will be seen that while in the beginning the Fairbanks Banking Company was interested in this First National Bank stock transaction only to the extent of the investment therein of $62,500 of its own funds, it did within four months thereafter become very much interested in the entire transaction through the investment of $250,000 of its own funds in the entire capital stock of its co-owner, the Washington-Alaska Bank of Washington. For an entire year $62,500 of its funds were directly dependent on this First National Bank stock for any return thereon and for eight months it was likewise dependent as the sole stockholder of its co-owner the Washington-Alaska Bank of Washington for any return on said $62,500 invested by the last named bank. For a year this profitless investment was carried by the two banks for the sole good of Wood and McGinn and without any cost to them whatsoever. When the Fairbanks Banking Company took over said Washington-Alaska Bank of Washington, it acquired as a part of the assets of said last named bank its right to interest on said $62,500.00 invested by it in said stock. The Receiver therefore has the right to recover interest on the entire $125,000.00.

The basis for recovery upon this item is that the officers and directors of the bank misappropriated the funds and property of the bank for the exclusive use and benefit of Wood and McGinn, and without benefit or profit to the bank. (Amended Complaint, Par. 28, R. 35.) While the purchase of said stock and the giving of said option were not the acts of the

same officers who afterwards concluded the sale to Wood and McGinn, yet such latter officers, defendants here, ratified the entire transaction when they consented to said sale being made "in pursuance to said option." This option was given at the time of the purchase of said stock by the bank. According to it, Wood had the right at any time within one year to take up the stock at the price paid for it by the bank. The bank carried the load until just short of the expiration of the option without dividend on the stock or interest on the investment. For whose use and benefit could the bank have been acting under such circumstances except that of the optionees? Coincident with the purchase by it, it gave to the optionees the right to buy at the same price paid by it at any time within one year. By this means the bank agreed to carry the investment for them without cost to them, and this these defendants, Jesson, Wood, McGinn and Brumbaugh ratified when they consented to said sale on these terms and under said option. This is not a question of holding the officers for making a bad bargain in purchasing the stock, nor for selling it at an under-valuation, on which matters the honest judgment of men might vary. The point here is that these officers permitted the bank's funds to be misappropriated to a use and benefit not its own. The fault would be just as great whether the value of the stock be small or great. The value of the stock is of no consequence except as it expresses the extent of the misappropriation. It might at first blush appear that the bank's officers who gave the

option committed the real misappropriation and therefore should have been proceeded against rather than those who ratified it and consented to said sale; but the act was not complete until the option was exercised. It might not have been exercised at all, in which event there would have been no misappropriation of funds.

For this misappropriation, the bank through its Receiver, is entitled to interest at the legal rate from the date of the misappropriation. *Cooper* v. *Hill*, 36 C. C. A. 402, 409.

In this manner McGinn and Wood got the use of this money without the payment of interest or incurring any risk of loss. McGinn was vice-president, and each was member of the board of directors of the Fairbanks Banking Company at the time the sale was made to them (F. 59). Each again safe-guarded his own personal interest to the exclusion of that of the bank, to which their fellow directors Jesson and Brumbrugh consented, and are therefore equally involved with them. For such they should be made to respond to the extent of the damage sustained which would be the loss of interest on the money so invested at the legal rate, which was 8%.

The principles of law applicable to directors and officers who promote their own interests by dealing with corporate funds have been fully discussed heretofore. Reference is again respectfully made to the following:

Michie on Banks & Banking, pp. 296-297;

Coddington v. *Canaday*, (Ind.) 61 N. E. 567;
Wardell v. *Railroad Co.*, 103 U. S. 651, 26 L. ed. 509;
Ryan v. *Railway Co.*, 21 Kan. 365;
Bosworth v. *Allen*, (N. Y.) 61 N. E. 163.

It is respectfully submitted that appellant is entitled to judgment on this item against appellees Jesson, Wood, McGinn and Brumbaugh jointly and severally for one year's interest on $125,000.00 at the legal rate in Alaska of 8%, to-wit, $10,000.

VI.

Interest on Foregoing Items.

APPELLANT IS ENTITLED TO INTEREST ON EACH OF THE FOREGOING ITEMS AT THE LEGAL RATE AS PROVIDED BY THE LAWS OF ALASKA, WHICH IS EIGHT PER CENT PER ANNUM, FROM THE DATE OF EACH MISAPPROPRIATION OF THE FUNDS OF SAID BANK.

—*Cooper* v. *Hill*, 36 C. C. A. 402, 409;
Burrows v. *Niblack*, 28 C. C. A. 130;
Bundy v. *Jackson*, 24 Fed. 628.

In the case of *Cooper* v. *Hill*, *supra*, in an opinion by SANBORN, it is said:

"When money has been misappropriated or converted to his own use by a defendant, interest

is given as damages to compensate the complainant for the loss of the use of his funds. In cases of the latter class, its allowance is sometimes a matter of discretion; *but it is a general rule, both at law and in equity that, whenever one has wrongfully detained or misappropriated the money of another, he must pay interest at the legal rate from the date of the misappropiration or from the beginning of the detention.*"

VII.

Recapitulation.

Appellant prays that the decree of the lower court be corrected in the foregoing particulars and that, in addition to the relief therein granted him, this court shall render a decree in his favor on the record herein against the following officers and directors of said bank in the following amounts:

1. Against the appellees John A. Jesson, James W. Hill and E. R. Peoples, jointly and severally, on the purchase of the stock of Strandberg Brothers, Emma Strandberg and B. E. Johnson, with interest thereon from November 18, 1908.................... $12,000.00

2. Against the appellees John A. Jesson, Ray Brumbaugh, John A. Clark, J. A. Healey, and George Preston, jointly and severally, on the purchase of the stock of John L. McGinn, with interest from October 13, 1910.... 6,000.00

3\. Against the appellees John A. Jesson, James W. Hill and R. C. Wood, jointly and severally on the purchase of the stock of R. C. Wood, with interest from June 30, 1908......... 13,000.00

4\. Against the appellees John A. Jesson, James W. Hill and R. C. Wood, jointly and severally for the purchase of the worthless Tanana Electric Company notes from Fairbanks Banking Company, a partnership, with interest thereon from March 16, 1908......................... 27,997.38

5\. Against the appellees John A. Jesson, James W. Hill and R. C. Wood, jointly and severally, for the purchase of other worthless notes from Fairbanks Banking Company, a partnership, with interest thereon from March 16, 1908.................... 41,911.56

6\. Against the appellees John A. Jesson, James W. Hill and R. C. Wood, jointly and severally for paying to Fairbanks Banking Company, a partnership, accrued interest on notes purchased from it, with interest thereon from March 16, 1908...... 39,642.81

7. Against appellees John A. Jesson, R. C. Wood, John L. McGinn and Ray Brumbaugh, jointly and severally for one year's interest upon the amount invested in the capital stock of the First National Bank, on account of the sale of said stock to John L. McGinn and R. C. Wood, with interest thereon from May 4, 1910 .... $10,000.00

All of which is respectfully submitted.

O. L. Rider,
Attorney for Appellant.